THIRD REPORT ON PROMOTING LONG-TERM PROSPERITY FROM THE COMPETITIVENESS POLICY COUNCIL

HEARING

BEFORE THE

SUBCOMMITTEE ON ECONOMIC GROWTH AND CREDIT FORMATION

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

SECOND SESSION

MAY 12, 1994

Printed for the use of the Committee on Banking, Finance and Urban Affairs

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THIRD REPORT ON PROMOTING LONG-TERM PROSPERITY FROM THE COMPETITIVENESS POLICY COUNCIL

THURSDAY, MAY 12, 1994

House of Representatives,
Subcommittee on Economic Growth
and Credit Formation,
Committee on Banking, Finance and Urban Affairs,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:15 p.m., in room 2220, Rayburn House Office Building, Hon. Paul E. Kanjorski [chairman of the subcommittee] presiding.

Present: Chairman Kanjorski, Representatives LaFalce and Fingerhut.

Mr. Fingerhut [presiding]. We will call the subcommittee to order.

The chairman is on his way, having just made sure that the final votes are tallied on his very important bill on the floor. I am sure he will want to make his opening statement when he arrives, but due to the time and due to the large crowd that has come to hear you, Fred, it seems to me we ought to begin.

We are once again pleased to have Dr. Bergsten before the subcommittee, and pleased to receive the third report of the Competitiveness Policy Council. The Competitiveness Council has made a singular contribution to our deliberations on government policy toward our economy over the last few years, and we welcome your comments today and your new additions to this debate.

Dr. Bergsten.

[The prepared statement of Mr. Kanjorski can be found in the appendix.]

STATEMENT OF C. FRED BERGSTEN, CHAIRMAN, COMPETITIVENESS POLICY COUNCIL

Mr. Bergsten. Thank you very much for inviting me to launching the council's third annual report to the President and Congress through this presentation this afternoon. I want to say at the outset how much I have appreciated the subcommittee's support and your personal support for all of our work. It has been a very important source of encouragement to us. We have enjoyed working with you and your colleagues closely on a number of issues and we look forward to continuing to do so. I think we are seeing some results, which is the bottom line and the most encouraging part of this process.

The council is today submitting its third annual report to the President and Congress. It is actually the fourth major report the council has issued. Last fall the council issued an interim report, a kind of initial score card on how the new Clinton administration and the Congress were doing in implementing some of the proposals put forward in our second report last March, for improving the country's competitive posture.

The council's third annual report includes a combination of further review of how things are going, plus some new proposals for the future. I have prepared some written testimony for submission to you, and I would ask that that be put in the record along with the report itself.

Mr. FINGERHUT. Without objection.

Mr. BERGSTEN. In the interest of time, allow me to simply tick off three central points at the outset and then open up for discussion on them.

The first, which we lead our new report with, is to assess the current state of American competitiveness. We do that partly as our normal function, that is at the core of our own responsibility, but also because, with the pickup in the economy, one is beginning to hear voices saying the United States has solved its competitiveness difficulties. After all, we are growing much faster, unemployment is coming down, we are looking particularly good compared with the major foreign countries, the Europeans and Japanese, who remain pretty much dead in the water, and so there are some who say the problem is over.

The council wishes it were so. We are certainly encouraged by the progress, and we think that the current improved state of the economy is a very good opportunity to move forward the agenda for dealing with some of the problems, but we are afraid we have to conclude that some deep underlying structural difficulties still remain. The council looks back to the variables that were outlined in its first report as being central to the problem of American competitiveness, and whereas there is progress on some, and there are policy initiatives to help deal with some, many are still looking not so good.

For example, our low national saving rate. You may remember that we put at the core of our proposals a whole strategy to sharply increase productivity growth in the U.S. economy. Without that, you simply don't get increases in standard of living and real economic performance.

In the last couple of years, productivity growth has been considerably faster. So we asked a couple of the country's preeminent experts on that topic to analyze it for us in-depth: Has there been a structural lasting pickup in productivity growth, or is this a temporary phenomenon which is the normal part of a cyclical recovery.

Unfortunately, the answer was primarily the latter. You always get a pickup in productivity as the economy recovers in the early stages of the business cycle. There may be a couple of tenths of a percent of more lasting pickup in productivity, but we won't know for sure for a while. There is certainly no evidence of any major pickup along the lines of the doubling or tripling that we have recommended.

When one asks why that is the case, one is driven back to the underlying sources of productivity growth. The level of investment in the economy, and particularly the level of national saving. And here the results are not only not reassuring, they are very much a source for concern. Private saving in the economy last year plummeted to an all-time new record low, meaning that we are generating even less of the domestic seed capital for improving our private investment and our productivity growth in the future than we had been in the past. That is clearly not a good sign for the future.

In addition, some of the indicators on the external side are getting worse. The trade and current account deficits, which had dropped below 1 percent of GDP as recently as 1991, are again rising very rapidly. This year the trade deficit will probably hit an all-time record level: $170 billion or so. It is on a course heading toward $200 billion or so next year.

Now, we don't put an overwhelming focus on trade or the trade balance as an indicator of competitiveness. As you know, we have a much broader definition: Standard of living of the American public. But the external position of the country is one good indicator of how we are doing, and the fact that the numbers are again deteriorating substantially is a cause for concern.

The rising deficits, also not so incidentally, increases our dependence on foreign capital to come in and provide investment funds. That, as we know from market disruptions over the last few weeks, is a particular source of concern at a time of financial instability. It also reminds us that being the world's largest debtor country and getting into debt by an additional $100 to $200 billion a year is not a very sound financial position and raises questions about how much basic improvement is going on.

The third and final point I would mention under this heading is simply that real wages and total compensation, which we think are probably the best measures of the country's living standards, are still not growing. They are stagnant and have not grown for 20 years. In some income groups of the work force, real wages have actually declined, and income distribution in a relative sense has gotten worse. So there are a number of indicators on which we are failing to make progress, and in some senses, maybe even getting worse. That is point one.

Point two concern policy efforts, particularly over the last 1½ years. Here we are reasonably optimistic. We think progress is being made. The budget agreement that you here in the Congress worked out with the administration last year is a significant step forward. It gives the promise of cutting the budget deficit in half as a share of GDP. That is the most promising way, in fact the only way we really know, to raise the national saving rate and provide more capital that can be productively invested. So that is a major step forward.

There have also been important legislative steps, including the Goals 2000 legislation for education, progress or technology legislation, the administration's proposal for worker retraining. So in terms of legislative action, and here we have many kudos for the Congress, but also in terms of additional proposals that have been forthcoming or are now before the Congress and are now being considered, we are hopeful and optimistic that the tide has been

turned. Conventional wisdom now recognizes the need to improve the country's competitive performance and policy focus in these areas, and therefore, further progress can be anticipated.

Here I would again underline the point made earlier that with the economy in a stronger position, we should be in a favorable environment, both to have more resources to devote to productivity-enhancing programs, as well as further moves toward reducing the budget deficit, thereby improving the national saving rate.

Third and finally on a point that has been of great interest to this subcommittee, and I know to the chairman, we have taken a hard look at the overall budget situation and the way it applies to the country's competitive position as a whole. One thing we have done, stimulated considerably by the conversation I had with the subcommittee last November, is to suggest the implementation of an investment budget for the Federal Government.

There are some striking facts that are hardly known at all in the country. One is that the share of government nondefense spending that has gone into public investment has been cut in half over the last 30 years. In 1965, we were spending about one-quarter of all of our nondefense outlays on public investment: Training, R&D, public infrastructure, legitimately defined investment needs. Now that number is about 11 percent, less than half what it was in the past. That is a decline of something like $40 billion of funding that otherwise could be put into high payoff, high productivity investment spending that could improve the country's competitiveness, increase our standards of living, and strengthen our economy over time.

So we believe as an important first step the administration and the Congress, through the CBO and deliberations between the two, should be highlighting the fact that the share of the government spending that goes to investment opportunities, high payoff for the economy as a whole, has dipped enormously and needs to be turned around. We then provide details concerning Federal training programs, basic education, public infrastructure, and R&D. The basic point is that we need a turnaround in the contribution of government investment to the country's economic future, and we think one way to shine the spotlight on that and begin to move in that direction would be through an investment budget.

The council focuses on the need to improve the quantity and quality of public investment. We want to work with Congress to push the administration in this direction.

I can report from some recent conversations with Laura Tyson, who is a member of our Competitiveness Policy Council, that the administration is considering our proposal in this area quite seriously. They are interested in it, believe it would be consistent with their own thinking, and, in fact, might help move ahead the programs that they would like to see take a bigger share of the Federal budget dollars. So on that one, I am encouraged by responses from the administration. I would hope to push it more widely in the Congress and hope that we could all work together in pushing ahead on that front.

I will stop here, but obviously be happy to answer any questions that you all have.

[The prepared statement of Mr. Bergsten can be found in the appendix.]

Mr. FINGERHUT. I thank you for the testimony. There are a lot of points that I am sure the chairman will want to inquire about, and I will, too, but particularly your responsiveness on the point of the investment budget which I am sure was on your agenda anyway, and was something that we had talked about in the previous hearings. If we are successful in convincing the administration and the Congress to adopt this approach, I think that we will strengthen the turnaround of the budget debate which is often less than enlightening.

The chairman, I understand, has voted. I will go vote and am happy to turn it back to you while I do that.

Chairman KANJORSKI [presiding]. Thank you very much, Mr. Fingerhut. I do appreciate it.

I apologize for being late, Doctor.

Your testimony mentions the concept of an investment budget to contrast the difference in Federal spending from short- and long-term needs. I assume you have some concept of the structure, and I would certainly appreciate hearing more about it to see what we could do with it.

Mr. BERGSTEN. I want to repeat one figure I mentioned just before you came in, because it is so striking. The fact that the share of government nondefense outlays going into public investment has been more than cut in half over the last 30 years. It was 25 percent of the government budget as recently as 1965; it was 11 percent last year. That represents something like $40 billion of reduced government spending on investment needs that would have been spent had the share of nondefense outlays remained at its previous level. So we are talking a lot of money. Enough, in fact, to fund most of the initiatives that have been proposed in recent years, the education, training, public infrastructure, R&D areas. So if we can at least get back even to the earlier share of government spending, at a time when the United States thought its economic situation was pretty good, maybe we need to go beyond that. But if we could get even back to that share, it could make an enormous difference.

What we would like to do is have the President, when he presents the annual budget through the work of OMB and the Cabinet and the like, begin to focus the spotlight on precisely this issue: How much of the government's budgetary spending is going for long-term investment that will have a payoff in two senses, a payoff in terms of long-term growth in the economy through enhancing productivity, and through that, higher standards of living for the American people. It strikes us that that would be politically popular, as well as intellectually sound, and so ought to sell.

In addition, I think it would support the basic thrust of the current administration's program. They are, after all, trying to improve public investment. They have made proposals, some of them already voted by the Congress in the education, training, infrastructure, and R&D areas, and putting this broad conceptual framework around the panoply of individual issues, we think would help.

One of the problems we flagged in our interim report last October was a failure on the part of the administration, and the public

more broadly, to clearly articulate and understand the linkage among a lot of the initiatives that have emerged since the start of the Clinton administration and the legislation that has been pursued to promote it in the Congress. We think there is such a linkage among a lot of the issues, all relating to the competitiveness question, that efforts that are undertaken in a number of these areas, which probably seem disparate and unconnected to even the intelligent newspaper reader or a layman are in fact a part of the larger mosaic, all intended to improve the country's investment posture, therefore productivity, therefore standard of living.

And the council believes that if a general rubric and foundation could be placed on which all the pieces could rest, the effectiveness and the understandability of all of the individual pieces would be much improved. This is the role we think an investment budget could play, expanding the focus beyond just the numbers, to include the conceptual consistency of trying to put the different pieces together. The council believes this would improve the chances for getting meaningful action of the type we are talking about.

Chairman KANJORSKI. It seems that prior to the election, a lot of us spent time talking about the difference between consumption and investment budgets, and it looked like the present administration was certainly going to make a commitment to the investment budget, and I think they have. I think the Congress has attempted to do that, in a way. But there does not seem to be receptivity in the media or the academic world to help explain that distinction to the American people.

What I am saying, Doctor, is that it is much easier to pass consumptive spending in government than investment spending.

Mr. BERGSTEN. Yes.

Chairman KANJORSKI. What suggestions do you have for those of us who are frustrated with the democratic process being able to attain that? For example, I just left the floor after the Economic Development Administration Authorization Act finally passed. A lousy third of a billion dollars a year, practically a pittance. But to listen to the opposition to that type of funding, you would think we had just mugged the Statue of Liberty.

Mr. BERGSTEN. Well, there is a problem, because of the short-termism that we pointed to in our first report as being a fundamental ill of American society, and of course, it infects this body as well as most others, perhaps even more so. But I am very attuned to the problem, because the Competitiveness Policy Council discussed this issue in its first year. We had a big debate ourselves as to this tradeoff.

It all comes back to a simple economic fact: The only way to raise the sustainable level of consumption is to increase the rate of growth in the economy, which requires increasing the rate of productivity growth in the economy, and that requires saving and investing more now. It is not, in other words, a tradeoff between consumption and investment. It is a tradeoff between short-term consumption and long-term sustainable consumption.

And the only way to get a higher level of income and consumption over the long run, is to alter the share of your current income that is spent on consumption versus saving. If you are willing to

consume a little smaller share of the growth of your income now, and invest that, you will ultimately raise the level of your income and your ability to consume more later. And the obvious evidence for that is that the countries whose consumption growth has risen the fastest are those who have had the lowest consumption share of their spending in the short run; That is, the higher saving and investment rates.

And this point, which is in a sense simple economics, is a little complicated for the layperson to understand. Therefore, the Competitiveness Policy Council has tried to put forward this relationship again and again, as a mantra of our whole approach.

When people are willing to reflect on this notion for a few minutes, they begin to understand it. If we could get the media and the policy process and the President in public speeches to call attention to this fundamental fact, then we might be able to make additional progress. It is not as if you have to take away from consumption now. You just have to devote a little greater share of the growth of your consumption to investment.

Say incomes are rising 2 to 3 percent a year. Instead of spending 95 percent and saving 5 percent, which is what we do in our good years (last year it was 98 and 2), you went to 90 and 10 or even 93 and 7, the discernible payoff 10 years from now, let alone 30 years from now is discernible. And that is the tricky point, but fairly straightforward. I believe people would begin to appreciate this point if our political leadership was willing to make this speech once a day and twice on Sundays.

Chairman KANJORSKI. Well, it is interesting. I guess what you are trying to do is use moral suasion to discourage people from consumption in the short term. But in a democratic society, that is very difficult to do. It strikes me that when I go back to my district, so often the chamber of commerce or the business community will feel that I am—you know, a sinner if I do not encourage consumption, business activity, everything that forces higher expenditure, and an increase of the productivity level.

As a matter of fact, the majority leader had a meeting not too long ago with many of us who are interested in this issue, and we were talking about using government as a tool to make a commitment of investment and a commitment of specific funding for that investment, long term. We could almost lock it in on the governmental side, but that is not quite a democratic process. It is tinkering, if you will, and I am not so sure that the public political mode is——

Mr. BERGSTEN. Here is an interesting calculation that we should have made and we haven't, but I will ask my colleagues now to do it. I have already referred to the cutting in half of the share of government spending that has gone into investment over the last 30 years. Most of the decline has gone instead into what you are calling consumption, entitlement programs, short-term transfer payments. Suppose over that 30-year period, the decline had not occurred, and that extra $40 billion in today's dollars had been spent for government investment every year over the last years, rather than on those consumption programs. I believe that a lot of the people who were calling for the consumption programs and feeling that they benefited from this orientation of government paying to-

ward consumption would be better off today had the money been invested.

Chairman KANJORSKI. Oh, I absolutely agree. The problem is, how do you convince them of that?

Mr. BERGSTEN. Well, maybe to give them a little historical picture like this and say we made a conscious or unconscious shift in the allocation of government spending over the last 30 years and we did it in response to you, Mr. and Mrs. Voter, because you wanted these short-term programs. I am here to tell you, you would be better off today if we had stuck with the longer term spending. And, certainly, in terms of their children's education—I mean, there is much concern today that the next generation is not going to improve the way the previous American generations have always been able to expect to improve. And the big reason for that is this failure to invest.

And if you can convince people that by giving up half a percentage point on their Social Security COLA their children would have had better education and they would be able to earn 50 percent more over their lifetime, maybe they would understand and buy that.

Chairman KANJORSKI. Perhaps we ought to have more of a display of the Japanese society to the American people.

Mr. BERGSTEN. Those comparisons, as I say, are really striking. Countries that only consume 70 percent of their annual income instead of 95 percent have shown enormous strides and will continue to do so. And that is demonstrable. We made a calculation in our last report that under traditional U.S. productivity growth rates, 2, 2.5 percent a year, our income doubled every generation, every 35 years, roughly.

Under the productivity growth of the last 20 years, our incomes double every 120 years. Now, that is a staggering difference that may not be evident next year, not even in 3 or 5 years, and that goes to your short-term horizon. But within the lifespan of the average American, these differences are very dramatic.

Chairman KANJORSKI. I am not sure that the efficiency of our investments is paying off. What kind of figures are you getting? I am talking about research and development.

Mr. BERGSTEN. Right.

Chairman KANJORSKI. The Federal Government pours $70 billion into it every year. I am not sure what the private sector puts into it. I am not at all sure that we are getting an efficient return on that $70 billion. Money earned is money that you do not have to make. If we had a more efficient return on our research and development investment, it would be as if we increased our income commensurately.

Is anyone doing some critical analysis of that?

Mr. BERGSTEN. Yes. The council has worked very hard particularly on that aspect of the question. I might add that we have been delighted to work with you and your staff, particularly in our Critical Technology Subcouncil, on some of your initiatives that we have supported and worked with you on.

In our last report we had two basic thrusts: One I have already been discussing, increasing national investment and saving levels to provide the wherewithal for productivity increase. The second is

to get "more bang for the investment buck," across the whole range of programs, and technology is one. We proposed a large number of reforms, all within the heading of shifting resources from defense-oriented to commercial-oriented, but also focusing on the transition from the laboratory to the product. We have focused partnerships between government, including Federal labs, and the private sector, cofinanced to make sure the private sector plays a serious role, but applying what the government's R&D spending does to the marketplace through intense institutionalized linkage with the private sector.

The council believes that this provides the best way at improving the "bang for the buck." When you partner with the folks who have to put their money up to make money, and are themselves responding to the pulse of the market, it maximizes the chance that government R&D spending will have a higher payoff. The council puts a very high priority on that and we think that ought to be the objective actually of all of these spending programs.

Chairman KANJORSKI. Now, this lends itself to great demagoguery, and I plead guilty of participating. Sometimes I cannot resist using certain phrases; for instance, academic welfare. I am not sure, though, that we are not starting to come up against a glass ceiling of the willingness in some areas—in my district, for instance, I am starting to hear people say that, you know, for this Federal investment all of these years, where can you point to the payoff?

Job creation and an increased standard of living occur in the immediate environs of the area of the investment, so that there is a detachment beginning to develop between districts that do and do not necessarily get immediate benefit from research and development money. There is a type of a jealousy that questions why money should go to research universities in dense areas, when that research helps improve the industry or business of the immediate area of the research institution rather than the hinterlands.

I can see a point not too far in the future where it is going to be very difficult to support the high level of Federal research and development spending and that will encourage even more demagoguery on our part. We have to find a way, it seems to me, to send that return on investment back to the average taxpayer, place it clearly in evidence before him, so that the taxpayer knows that it is efficient and effective, it is not illusory, and it is certainly not academic welfare.

Mr. BERGSTEN. Again, I think it goes back to the overall efficiency of the R&D investment. It would be difficult to always seek a payoff from an R&D investment that immediately accrues to the same congressional district or even State or even region. Obviously, you can't do that. But there is increasing evidence, interestingly in some of those same academic ivory towers, that more and more economic growth is being generated in particular and narrowly defined geographical locations. Neighborhood effects are becoming evident, such as those as a result of the North Carolina Research Triangle.

Chairman KANJORSKI. Boston.

Mr. BERGSTEN. Right. There is more and more evidence around the country, and the evidence is that those neighborhood and geographical propensities are very important both in stimulating

growth and in translating local investment into local payoff, job creation, and higher economic benefits. So I think there are some persuasive answers to the question, although I recognize that obviously you can't expect the payoff to be just down the street. One district benefits from spending in another district across the country and visa versa. This is the whole principle of trade with a common market, which the United States is. Pennsylvania benefits from California's investment and visa versa.

Chairman KANJORSKI. I guess what I am trying to say, in simple mathematical terms, is that if you took 1 year's expenditure on R&D and divided it by the population, it would turn out to about $280 a head. In some congressional districts, residents begin to ask the question, why should we invest our $280 per head in research and development when it only improves Boston or Cal Tech's immediate area? We have to find some way to take that technology out to the hinterlands and show people that the investment is coming back.

Mr. BERGSTEN. Yes. I was going to say a lot of the answer is presentational, being able to demonstrate what the tangible payoffs from the R&D spending will be in terms of spinoffs to industrial application, including down through second, third, and nth levels of suppliers creating jobs all around.

One model for that perhaps is the international trade area, which I happen to know the best. In support of trade legislation over the years, the U.S. Government has developed highly disaggregated data on the benefits of international trade, which even is a little more remote, to individual districts. For example, how many jobs in a district in Idaho are created by Boeings' export opportunities in China, and then passed through to the suppliers. That has been done to a very large extent in the trade area, in part to respond to exactly the kind of practical and political question you raise, and I think it could be done, but it has not yet been tried in this area.

Chairman KANJORSKI. We could construct a model and then have that evidence. Very good.

Mr. Fingerhut, you had some questions.

Mr. FINGERHUT. Thank you, Mr. Chairman. You are pursuing the line of questioning that I was interested in as well, the whole notion of investment and savings versus consumption spending. Let me approach it from a slightly different angle.

You said, I think, deficit reduction—and you praised the Congress for its efforts in this regard last year—is the one certain way we know to increase the level of investment and savings. Yet you also said that investment and savings actually is at its lowest levels in a while, or historically, I don't know what the timeframe was, and that it actually was a very disappointing year in that regard.

How do we square the fact that we took a pretty serious step that should have been a positive, and instead it seems that the result has been the opposite?

Mr. BERGSTEN. What fell to a record low last year was actually private saving, just that component of total saving. Government saving actually did rise by a somewhat offsetting amount because of the first stage of cutting the budget deficit. The private saving

rate came down further, but the government saving rate began to rise as a result of the budget correction. Therein, however, lies a very important question because, historically, there have been offsetting moves in the two.

Historically, the national saving rate in the United States has been amazingly constant from the time data were first collected, about 1860, through about 1980. Because when private saving would drop, government saving would rise and vice versa. There were a lot of automatic linkages between them, but the bottom line is that they tended to offset each other. Then, however, things shifted dramatically, because in the 1980's, both began to decline. Government saving became huge dissaving with the massive budget deficits, and private saving, despite the promises of the supply siders to the contrary, plummeted as well. The result is that the national saving rate fell by a very large amount.

Now the hope would be to get them both going back up in tandem, as opposed to the offsetting tendencies of the past. There is only one way we really know how to get the national saving rate at least headed in the right direction and that is by bringing the Federal budget deficit down. The council has continued to work on ways to promote private saving, not just through moral suasion, but through more concrete measures. The honest truth is that we don't know whether these steps would restore the movement of public and private saving to move in tandem back in the right direction or whether the moves of the historical past might even obviate some of the benefits from the budget reduction.

Mr. FINGERHUT. Well, in fact, with respect to private savings, haven't we really done the opposite? We proceed, for reasons of wanting to stimulate the economy, which most of us appear to support in low interest rate policy which, if anything, encouraged consumption, private consumption, which did stimulate the economy and did produce the job growth and all of the other benefits that are giving us the chance now to correct our public finance policies. It seems to me that it is pretty clear why we, if anything, saw a drop in private savings over the last year.

I have seen you on television a few times as the interest rates have fluctuated and people look around for wisdom on what is happening in the international financial markets. It would seem to me that a side benefit, I guess, if there are any benefits to be seen in a slight raise and ultimately a stabilization of interest rates might be to encourage some private savings because there will be a return there, that people might be willing to actually see a return on their savings.

Mr. BERGSTEN. Well, that might be and that is the conventional wisdom of economists and that has been the historical record. However, in the 1980's we went in the other direction. In the early 1980's, we had an economic environment that as you suggest, and traditional logic supports should have promoted a big increase in private savings. Interest rates, you will recall, went sky high and even when you correct for inflation, real interest rates went sky high. You also remember the early tax changes which improved tax treatment for investment earning.

There were a variety of factors that should have made the environment more conducive to private investment than anytime in

modern history. Yet, private investment plummeted. Nobody has really explained it satisfactorily. I have a hypothesis, which is a very disturbing hypothesis and it is that we always had the theory backward. Americans indeed have a saving target; they want to earn a certain amount of investment income. And that means if interest rates are higher, they can get away with saving less, because the higher yield gives them the flow of investment income they had in mind. Likewise, if you reduce the tax burden on investment income, they can save less and get the same after tax yield.

We know that this is precisely how a very large share of national saving, corporate pension funds, operates. Corporate pension funds and individuals with Keough plans or 401Ks are target savers. As you know, these pensions are calculated on the basis of your investment yield and therefore, the stream of investment income that will be generated upon retirement. So it is literally true that as your investment income return rises, you need to save less. In fact, under a Keough plan or a 401K, you are permitted to save less with tax deductibility in succeeding years, if your investment return does better than anticipated.

This part of saving, corporate pension plans and the like, are now the lion's share of private savings in the United States. It is not individuals going down to the bank and putting money in a bank account or buying a CD. So if there are smart savers and maybe others are target savings for similar reasons, maybe we have had the theory backward. That is the only way I can actually explain what happened in the 1980's.

Now I hesitate to put that forward. We have only had a decade, and one needs to look at long historical periods. Some of my colleagues in the economics profession believe that; others are skeptical. Most would say it is too early to say, maybe there are other aberrants we don't understand. Only to say, in a long winded way, that the conventional wisdom doesn't explain what has happened lately, and it could even go the other way, which would be very disturbing, but would also raise some very profound policy implications.

Mr. FINGERHUT. One other question if I could. I particularly applaud your pointing out to the Congress and the country that it is a time of relative prosperity, of economic growth, that we have the ability to correct some of our underlying problems. My personal view of what happened in the 1980's is that the government, the Congress and the administration, probably appropriately stimulated the economy and engaged in deficit spending at a time when there was a deep recession, but it was during the period of prosperity when corrective actions should have been made and were not made. We shouldn't make that mistake again.

Which leads me back to the subject of the budget and the general deficit problem. We did do a substantial amount of work last year with you, but we have shown a remarkable lack of desire to do more. It particularly occurs to me on the subject of consumption spending, which in our budget translates almost overwhelmingly to health care—you have addressed the subject of health care here.

I am growing increasingly concerned that we are focusing all our attention on the private sector health care marketplace, how to make sure that we have universal health care, how to decide what

small businesses can contribute and what is the most efficient way for them to contribute, and what is the standard package of benefits and all these kinds of very important public policy questions. But we are not laying a finger on Medicare, we are barely touching Medicaid it seems to me, and until we do that, we are not going to turn around this consumption versus investment problem in our Federal budget nor are we going to help alleviate some of the States that are having the same problem.

Are you willing to wade into that and give us some guidance or at least comment on my characterization of where we are?

Mr. BERGSTEN. Two points. One is the general budget point and the current debate that you have had in the Congress over the last few months: Has the budget cutting package to date been adequate? There were some congressional initiatives to further reduce the deficit, and the administration opposed them. I wonder whether the administration now thinks it was right. With the current developments in the financial markets, the great concern about inflation, and pressure on the Federal Reserve and not the markets themselves to increase interest rates, it may have been better to have a little quicker tightening of fiscal policy, to dampen both the growth outlook itself but more importantly the psychology surrounding it.

Mr. FINGERHUT. Better us do it and get the public benefits than the Fed do it for us.

Mr. BERGSTEN. Exactly. And I would bet in its heart of hearts the administration might be having second thoughts. They didn't accurately predict what was going happen, nobody did in the financial markets. The fact is that this is the ideal time to alter your policy mix, tighten fiscal a little more, thereby not have so much pressure to tighten interest rates and raise interest rates and tighten monetary policy.

Then you get the long-term structural payoff from the lower budget deficit, the higher national savings rate, and you rely less on action that can hurt housing and other consumption-oriented parts of the economy, and particularly to hurt investment through higher interest rates. If so, if we could have accurately foreseen what is going on now, and maybe there is still time to do it depending on your forecast of the future, it would be much better to have a different policy mix.

Instead of the markets pounding on Alan Greenspan and the Federal Reserve every day, raising interest rates more and do it faster, wouldn't it be better to take advantage of the occasion to further tighten fiscal policy. If some of your bills a couple of months ago would have passed, I don't know if it would have headed off part or all of the market dispute. But if one believes that the underlying fear in the market now is of incipient inflation because of pushing off productive capacity, the obvious way for the government to deal with that problem is not through higher interest rates but by taking more pressure off capacity utilization; that is, a lower budget deficit with all the long-term benefits.

All I am saying is, it goes back to the question of short-termism. Even in the short term, it would be better to take advantage of the occasion to have a tighter fiscal policy. We are into it already. This

would have been lovely to do 6 months ago, but if it is going to continue and maybe it is, maybe there is still time.

Mr. FINGERHUT. Thank you.

Chairman KANJORSKI. I marvel at the short memory of the media and the American people. If you recall, when we were passing the budget arrangement, there was a large portion of the House and Senate talking about the potential falling of the heavens upon the Earth and how catastrophic everything was in the arrangement. All of those quotes that I remember from those nights on the floor are no longer remembered.

Now it is assumed that everybody was there when the water was being carried. I seem to remember it took every one of us to carry that bucket to a man before it got through.

Mr. BERGSTEN. I go back slightly further to the start of the Clinton administration and the ill-fated Stimulus Program, and we in our report to you about a year ago basically said that was a mistake. Keep your eye on the long run; deal with the underlying problem; alter government spending in a way that will have bigger bang for the buck, but don't confuse short-term cyclical stimulus with long-term investment spending. When we did our midterm report last October, we went back and looked at that and said we felt that the Stimulus Program proposal had actually confused the public in a serious way by confusing short-term stimulus and long-term investment, and had, in a sense, undermined the new administration's proper focus on competitiveness investment long term by mixing it up with the short-term stuff. I think in retrospect it now looks particularly clear for the reason you are saying.

Chairman KANJORSKI. To exercise the political courage you suggest, it does require an enlightened electorate and that seems to be our problem. There are those of us that were willing to carry that water, but it does not seem to me that the information fed to the electorate has operated to sustain that political courage. It is easy to retreat into a consumption-driven economic——

Mr. BERGSTEN. It should be possible to persuade people that spending a tiny less share of their income now will lead to much higher consumption and standard of living later. But the person who probably has to make that point in speech after speech is the President. This President, with his focus on investment and long term and competitiveness, ought to actually be the person to do that, and we are certainly pushing him to do so.

Chairman KANJORSKI. I am going to call on the father of your council, proper accolades and attention that a senior member of the Banking Committee deserves. We have not forgotten his presence. We are giving him the final time for the benefit of his wisdom. The gentleman from New York.

Mr. LAFALCE. You are much too kind.

Dr. Bergsten, it is a pleasure to have you before us. Each chapter in your report is worthy of a separate hearing, so we will do that.

Mr. BERGSTEN. When do we start?

Mr. LAFALCE. In the meantime until we get to that, let me focus on some issues that are current in the press and macroeconomic arena right now. A few months or so ago Dr. Greenspan was before the full committee and in an attempt to justify the beginning of his increase in interest rates spoke of the need to deal with inflation-

ary expectation. They were anticipatory actions that he was taking, which raises a whole host of questions.

To what extent are the inflationary expectations real as opposed to perceived expectations? Whenever you deal with expectations, it is difficult. How near term are they? Therefore, how soon should you be acting? Are they 3 months away, 6 months away, 1 year away? The further away, the more difficult it is to really see the flesh and bones on these expectations. But what criteria should you be using to judge so-called inflationary expectations?

In trying to pin down Dr. Greenspan to criteria, it was very difficult because criteria are difficult to come up with. I am probably doing him a disservice because I don't have his testimony before me, but I tried to pin him down. My judgment was that there were two real criteria. One, his anticipated reassessment at the time of the fourth quarter 1993 increase in GNP which was supposed to come in at around 3.5 percent, which the Fed thought would come in at around 5.3 percent but ultimately came in at 7 percent.

So I am wondering about the validity of increasing interest rates if there is an increase in GNP that is more significant than you thought and it is only for one quarter.

Second, he ascribed to it certain increases in commodity prices, most especially the price of gold. In my dialog with him, this was the first time he revealed himself to be what some refer to as a gold bug.

The *Wall Street Journal* in an editorial a day or two later discussed the dialog we had had and said, hurrah, he has now made public what we always thought he should be and really was. But I have questions about the legitimacy of using increases in the price of gold as an indicator of inflationary increases. I wonder if we don't have a vicious cycle going on here that is feeding upon itself.

Third, although he did not articulate this, I wonder if it could have been true then, or whether it is true today, that one of the reasons for increasing interest rates then and perhaps one of the factors that is being considered today is the fall of the U.S. dollar. Of course, within the past several weeks we have been doing all we can to intervene in international financial markets in order to buttress and stabilize the value of the dollar. We see not only purchases being made on an international level by the heads 17 central banks in considerable sums of money. We see not only the Bundesbank lowering the interest rates as well as France, all of which probably were good because of the need for additional economic stimulus within those countries. Whether it should be done in order to buttress the dollar or not, and whether this is also going to be a reason for increasing our interest rates is questionable.

What is the relative value that we must place upon dealing with inflationary expectations considering these difficult criteria for determining what inflationary expectations are, trying to defend a free fall in the price of the dollar, and preventing it from going very much lower than it is, against the harmful side effects of increases in interest rates which could stifle economic growth and economic recovery. These inflationary prospects which might not really have been as great as one would have thought by looking only at one quarter, and economic recovery might not be as great as thought

when you consider the terrible inadequacy of our unemployment data, its misleading nature, and the growing disparity within the United States and the world between the haves and the have-nots.

Chairman KANJORSKI. We would like your answer in five words or less.

Mr. BERGSTEN. Mr. LaFalce, who is the father of our council, said that each chapter of ours was worthy of a separate hearing. Each of his questions is worthy of a separate hearing.

I would preface it by saying that in my testimony and in our report we have brought a helpful dose of pessimism to the debate. I say that quite seriously, because as your questions imply, I happen to take the view that the markets are completely erroneous in their assessment of the risk of an inflationary pick up, and that is in turn because they overestimate the likely real growth of the economy.

I am not by nature a pessimist; to the contrary. But when we did our review for this report of whether America's competitive problems and economic woes were behind us, we came to some rather sobering judgments. Maybe if we can maximize public attention to our new report we can help the market condition by reminding people that most of our fundamental problems like the saving rate have not been solved.

Therefore, it is inconceivable that we would go ahead not only with 7 percent growth, but even with 3 or 4 percent growth. It doesn't work mathematically when productivity is expanding at best at 1½ percent and national private savings at the lowest rate in the postwar period. It can't happen and Alan Greenspan is the first to know that.

What are the criteria for inflation expectations? For inflation expectations there is only one indicator, the market interest rate. That is the way you judge what the expectations in the markets are. So the sharp rise in market interest rates clearly is an indicator of inflation expectations.

The next question is, are those based on reality? My answer is no. I think they are completely overstated. And I think there will be a retracing in the market as soon as that is understood. But you have one number like last Friday's job number which comes in more rapid than people expected, and you get continued spooking of markets, including spooking of the Fed. The Fed is following the market not leading it.

If anything, that is a bum rap on the Fed. If anything, the Fed is being accused of going too slow. Rates have not gone up very far, and even if they go more, which I am sure they will unless the numbers turn around quickly, they basically follow the market, not lead it. I think it would be hard to say that they autonomously pushed interest rates up or had an adverse effect.

I think the administration has been spooked in its activity in the exchange markets. There is another point there that is quite important. The Secretary of the Treasury said a week ago that the dollar was undervalued and should be pushed up by intervention. The U.S. trade deficit this year will hit a record level, probably $170 billion, $180 billion. Next year it will probably hit $200 billion. It is hard to say in the face of that that the dollar is undervalued, that is, should be strengthened, which would hurt our competitive-

ness. You want to make sure the exchange rate doesn't overprice your product in world markets. That is the surest way to kill your competitiveness.

But for the Secretary of Treasury to now be advocating a stronger dollar in the face of record trade deficits is a bit peculiar, and I think not credible to the market and therefore undermine what is being done. I understand their being spooked.

My colleagues and I introduced the concept of a "hard landing" 10 years ago, which says that if foreigners really get worried about your market, Americans worry and put their money abroad, then two things can simultaneously happen. Your currency drops which pushes up inflation and does other nasty things, but also your interest rates rise because of the pulling out of your bond markets and demand for the bonds drop so that means the interest rate on the bonds increases. So you can theoretically get the so-called hard landing.

I see no evidence in recent events that that has happened. What happened over the last 2 years is the yen rose substantially. During that period the dollar was the world's second strongest currency. It had gone up against every currency in the world, the last 2 years since Clinton was inaugurated. What has been happening lately is a modest retracement of the dollar against the mark, which I think is because of a change in market expectations on relative growth between United States and Germany.

For a hard landing to occur, two things would have to happen. The strength of the yen would have to translate into a generalized and sharp fall of the dollar against all currencies and that in turn would have to pass-through into the bond markets and discourage foreigners and get them to pull out. I don't see much evidence of either chain of that logic occurring. Treasury can argue it is afraid that it is going to happen. They get paid to get worried and obviously are very deeply concerned about higher interest rates. They want to head off further movement in that direction, so you might write it off as kind of a precautionary step.

The recent intervention to strengthen the dollar was a pretty far-ranging action: 17 central banks, $5 billion in 1 day. I think it was a mistake and unnecessary, but reacting to these market expectations which clearly were there because of the higher interest rates.

On commodity prices I fully agree with you. It would be totally irrational to base any iota of our monetary policy on the price of gold and not much less irrational to base it on commodity prices more generally.

Mr. LaFalce. He said he is clearly doing that.

Mr. Bergsten. I hope he is not, because the gold price is driven by a horde of factors that are irrelevant to the current state of the economies here, abroad, or anywhere. If some central banks decide they are short of liquidity in terms of foreign exchange to finance their exchange market intervention, they will sell some gold. If South Africa or Russia or producing countries are having economic problems of their own unrelated to the world economy, they will sell some gold and that will affect the markets. Or if they are doing well, they will withhold the gold supply and the price will rise. There is a host of irrationalities. As for commodity markets as a whole, the prices have gone up from lows not reached since the

Great Depression and the levels of commodity prices in the aggregate are still not very high, so I wouldn't get excited about inflation stemming off those indicators.

Mr. LAFALCE. A few followups. I had a hearing this morning with Larry Summers and others on global privatization efforts and the lack of a U.S. policy to attempt to ensure socioeconomic justice as part of the privatization process. I would call this "Empowerment Privatization" that can help more equitably distribute existing potential societal wealth.

Unfortunately, he had to run before we could get to these issues, interest rates and dollars. Is Larry the driving force in Treasury in this arena? I am going to be pursuing it with him next week. I really think that we are off on the wrong track with interest rates and the unnecessary fear of inflation and this concern about this one-quarter blip. I don't see any signs of the economy being even a little bit overheated.

Mr. BERGSTEN. The only chink in that argument is the one possible chink in your then linking it to government policy. There are those market expectations and, at least if you believe what you hear from people in the markets, their expectations are influenced to some extent by their reading of government behavior and government policy—the administration is soft on inflation, or its Fed appointees, or benign neglect of the dollar, and so forth, all of which I think is nonsense in substance. But if it is in the minds of the market and that in turn is driving interest rates sky high, which could seriously impede the recovery, then it is incumbent on the administration and the Fed to try to clarify or alter those views of their own behavior, and that can unfortunately lead to measures, at least for a while, that do run counter to what is substantively called for.

On the other hand, you can't go to the other extreme and totally ignore the mindset of the markets, irrational as we agree it is. That is the dilemma I know from having been in the job that Larry Summers or anybody in the government faces and sometimes they may have to do some things that they know are not quite what you want in substantive terms in order to cope with perception.

Mr. LAFALCE. One last thing. Within the past week, a lot of attention—well, in some circles, attention is being given to Paul Volcker's Bretton Woods Commission—it sounds like what you and I have been talking about for years. Have you been involved in it and what is happening there?

Mr. BERGSTEN. I am on the executive committee of this so-called Bretton Woods Commission, which was set up a couple of years ago to take a look at the adequacy of the international economic institutions, the IMF, the World Bank, and the structure that they rest on, given this is the 50th anniversary year of the Bretton Woods system. It goes back to 1944, so a natural time to take a look at it.

That is quite an elaborate commission, a lot of very top people from Europe, from Japan, from the United States, a few from developing countries. We have been discussing it for a couple of years.

You are right. The somewhat cautiously worded recommendations of the group, at least as they now stand, will move very much

in the direction of what I and a colleague invented 10 or so years ago, a moving target system for currencies. I know you support this idea.

The idea would be to try to improve the stability of the monetary system, avoiding disruptions and particularly avoiding big misalignments of currency that could result in over or undervalued currencies, lead to big trade deficits, protectionist trade policies, and the like. The Institute for International Economy is hosting a conference next week, a separate exercise, also looking at the reform of the international institutions on the 50th anniversary of Bretton Woods, looking at a broader set of things, including trade, environment and other issues, but I think with this 50th anniversary of the Bretton Woods system upon us now, there will be a number of efforts to start the process again of reforming and improving.

On the monetary side, we have had a nonsystem for many years, since the old fixed-rate exchange system broke down. We should not return to the fixed exchange rate system but try to move in the direction of a more stable and more effectively functioning system. I think target zones could do that. Other governments have experimented with it. De facto, we may even have this system today. In reality, we haven't moved very explicitly in that direction and Paul Volcker's group will contribute to the effort to move in that direction.

Mr. LAFALCE. I have got a pretty good fix based upon my reading of Allen Binder's essays over the years. I don't know much about Janet Yellen except the fact Laura Tyson recommended her and she comes out of Berkeley. Where does she fit in the economic constellation?

Mr. BERGSTEN. I am embarrassed to say I don't know much more about Professor Yellen than you do. She has a very good reputation. Her husband is an economist with a good reputation. I have talked to some of her colleagues. All have very high regard for her.

I think she would be a very balanced and constructive member of the board. I can't give you a lot of independent assessment of her work. It is not in my particular area, so I am not on top of it.

Mr. LAFALCE. Thank you, Mr. Chairman.

Chairman KANJORSKI. Are you sure that we have the tools to measure the things we purport to measure?

When you look at savings and creation of wealth, you may say that if we spend $3,000 on a new computer, that is the value of that computer, when in reality that computer now gives me the property value of the entire Library of Congress. We are just measuring the cost of the computer as opposed to what is opening up to us. I am beginning to wonder whether our measurements—I was listening to my colleague talk about gold and I remember that discussion with Alan Greenspan.

It seems that that type of a commodity to use as a measure for anything today is very obsolete. Are you moving forward to start testing fundamental values of the economic system and how we measure them?

Mr. BERGSTEN. Yes, and your example of computers is a good one because that is a way to measure productivity. When you get your

computer and therefore can tap the entire Library of Congress with the touch of your finger you enormously increase your productivity.

Productivity and the standard of living are two of the most difficult indicators to measure. Productivity is essentially a residual in the statistics, calculated largely in an indirect rather than a direct way. It is subject to all sorts of measurement error.

There are a number of economists who think we are understating productivity growth in the economy for the reason you mentioned, an inability to capture the benefits from computation and the electronics revolution and we really haven't been able to figure out how to judge not just the benefits to an individual, but to business. There is a widespread view that it took business about a decade to really figure out how to harness the computer to improve productivity.

The school of thought which says we are now doing much better, and that our productivity growth is much better than the numbers show argue this point and agree that in the 1980's productivity did not pick up very much, but now there has been a quantum jump as industry has learned to use that new tool much more effectively.

There is a big debate on that and there is a lot of work going on trying to measure productivity more effectively. We are monitoring in that work. The council's third report takes a careful look at the extent to which the recent recorded growth in productivity has been real and lasting and long term rather than cyclical. The result of that survey was not very encouraging. Nevertheless, part of that reassessment is to look at the underlying fundamentals, and we will certainly continue to do that. That is central, I agree.

Chairman KANJORSKI. I would like to get the benefit of what you see there because it is very difficult for us to explain what kind of wealth or productivity creation exists today and how we should now measure it, particularly as we allocate the Federal budget.

What would be, in your estimation, the three most important things the Congress could do right now?

Mr. BERGSTEN. I think I would put at the top of my list further reform of the education and worker training systems to strengthen the Nation's human capital. That was what we identified as a top priority in our second report last year, in the detailed strategy we laid out for you. There has been some progress, but it is only a start, and there is legislation pending particularly on worker training that needs to be addressed, maybe beefed up, and then implemented. But human capital as a long-term investment is more important than anything else.

Second, we must focus on getting a bigger bang for the government investment buck—how can we reallocate government spending in a way that will really help the economy and the population over time. And that includes the educational effort that we talked about, trying to get people to understand that; but part and parcel of it would be policy measures to increase the investment share of government spending because we know and we can hopefully communicate to people, that it is in their interest over any reasonable period of time.

Third, go back and look at the budget again. Keep reducing the budget deficit. Certainly, as you look at health care, and we flagged that in our report this time, certainly, make sure that what you do

continues the progress in budget reduction that has been set in place. At a minimum, don't make it worse, but given the pickup of the economy that was unexpected, maybe look for additional measures now that can keep trimming the budget deficit and raise the national saving rate. I think I would put those three at the top of my list.

Chairman KANJORSKI. Doctor, I appreciate your testimony. I know it is late. I appreciate your report. We are going to go over it again. We would like to work with you much more closely on this. We will allow the members to submit questions and would appreciate your response.

Mr. BERGSTEN. It has been a great pleasure working with you and your colleagues on a number of issues. We appreciate your support and we look forward to staying in very close touch and maintaining the collaboration.

Chairman KANJORSKI. Thank you very much, Doctor.

[Whereupon, at 3:30 p.m., the hearing was adjourned.]

APPENDIX

May 12, 1994

SUBCOMMITTEE ON ECONOMIC GROWTH AND CREDIT FORMATION
COMMITTEE ON BANKING, FINANCE, AND URBAN AFFAIRS

OPENING STATEMENT OF THE HONORABLE PAUL E. KANJORSKI CHAIRMAN

HEARING TO RECEIVE A REPORT ON PROMOTING LONG TERM PROSPERITY FROM THE COMPETITIVENESS POLICY COUNCIL

May 12, 1994

The Subcommittee meets this afternoon to receive testimony on the Competitiveness Policy Council's publication, *Promoting Long-Term Prosperity: Third Report to the President and Congress*. I am very pleased that Dr. Fred Bergsten, Chairman of the Competitiveness Policy Council, could be with us today.

Last year, this Subcommittee passed H.R. 2960, a bill introduced by Representative LaFalce to reauthorize and rename the Competitiveness Policy Council. This bill was passed by the House on November 21, 1993. It is a credit to the Council that their reauthorization bill passed out of subcommittee unanimously and without amendment. Clearly, authorizing funds to facilitate the Council's efforts is a sound and low-cost investment in America's future. The Senate has yet to take action on this legislation, and the Subcommittee would strongly encourage them to do so this year.

The Competitiveness Policy Council was created in 1988 by the Omnibus Trade and Competitiveness Act. The Council was founded in 1991 and is charged with recommending policies to restore United States' competitiveness in the world economy. The professionals that serve on the Council share the common goal of helping the United States return to preeminence as a world economic power.

The Competitiveness Policy Council has formed nine subcouncils, or task forces, to specifically examine what is needed to return the United States to a nation of strength in the global market. These subcouncils examine areas such as the Nation's education system, training resources, critical technologies, corporate governance and financial markets, trade policy, capital formation, manufacturing, public infrastructure, and capital allocation.

Dr. Bergsten's testimony states that the Council has determined that this country's competitiveness problem is a result of *"...short-term perspective, lack of proper economic incentives, and inattention to the global competitive environment."* I could not agree more.

I also note in Dr. Bergsten's testimony that the Council calls on the Administration to establish an investment budget and to set a target for total public investment. While this recommendation may sound simple, its importance is enormous. There is a fundamental and critical difference between expenditures by the government which invest in our people and our communities, and expenditures which are directed toward consumption. Yet our current budget process fails to adequately make this crucial distinction. Today, we in Congress treat all expenditures as equal and therefore understate the importance of returns to the government and the American people through sound federal investment in our future. As I have noted in the past, the private sector recognizes the difference between investments and consumption; these differences are clearly reflected in the budgets and balance sheets of private sector businesses. Dr. Bergsten is absolutely correct that it is time we in the Federal government recognize this fundamental distinction.

Consistent with making a distinction between investment versus consumption expenditures is working to maximize the returns on the nation's past investments, particularly in the areas of science and research. One of my main convictions is that we in the Congress must develop a way to bridge the gap between innovative technologies developed in this Nation's government laboratories and academic institutions, and the effective commercialization of these technologies by United States private-sector businesses.

Through research in Federal laboratories and at colleges and universities, our country has accumulated tens of thousands of patents, licenses, and technologies. These represent trillions of dollars in assets which should be used to create businesses to fuel economic growth and revitalization. Yet today, the primary beneficiaries of America's investments in research are our trade competitors, <u>not</u> United States businesses.

I have proposed, through an amendment to H.R. 2442 that was passed on the House floor yesterday, to build a comprehensive, nationwide database of information of federally funded new technologies. In conjunction with this database, I have also proposed that a private corporation, the Business Development and Technology Commercialization Corporation, be established to assist federal labs, agencies, and universities in marketing and licensing their technologies nationwide.

Dr. Bergsten's testimony addresses the decline in public investment in education, training, infrastructure, and research and development since 1965. I believe that the effective commercialization of federally funded research could provide a valuable return on the investment the government has made in technology development. My program will help small- and medium-sized businesses remain competitive in the increasingly high-tech international marketplace of the 21st century. This proposal will also help create and expand thousands of businesses, and tens of thousands of good jobs at high wages in this country.

I am very interested in the discussion of American competitiveness, and I look forward to your remarks. Thank you, Dr. Bergsten, for participating in today's hearing.

Testimony of C. Fred Bergsten

Chairman, Competitiveness Policy Council

before the

Subcommittee on Economic Growth and Credit Formation

House Committee on Banking, Finance and Urban Affairs

May 12, 1994

Thank you for the invitation to appear before the Subcommittee this morning to release the Council's 1994 report, "Promoting Long-Term Prosperity" to the House of Representatives. The report is also being sent to President Clinton and to the Senate in accordance with our statutory mandate.

This is the fourth in a series of major reports prepared by the Council. In 1992, the Council diagnosed America's competitiveness problem as resulting from a short-term perspective, lack of proper economic incentives, and inattention to the global competitive environment. In 1993, the Council presented more than 50 specific recommendations for federal policy changes. These reforms were recommended by our subcouncils, which are inclusive groups for bringing together thoughtful representation from business, labor, government, and the public interest. In October 1993, we presented a preliminary assessment of the progress of the new Administration and the Congress in implementing our "comprehensive competitiveness strategy."

This year, the Council reports on the state of competitiveness in America one year into the Clinton Administration. Our major conclusion is that the current economic recovery, while broadly welcome, will not be enough to reverse the twenty year erosion in the nation's competitiveness. In spite of goods news about the economy, many of the fundamental economic indicators -- such as the saving rate, investment in plant and equipment, R&D, and public infrastructure, accumulated debt and the trade imbalance -- remain disappointing. Real wages and total compensation, the best measures of the nation's living standards, are falling or at best stagnant.

The Council welcomes the numerous pro-competitive actions taken by the Clinton Administration. The budget agreement was a notable achievement. We commend the enactment of important legislation regarding education and technology. Still, there is much more than can be done and we made several specific recommendations in our report. We believe that the present period of economic strength provides an unusually favorable environment to begin making the needed additional changes and thus urge early action on them. Let me briefly highlight a few areas of our study.

Health Care

The Council examined health care as a competitiveness issue. From that perspective, we urge reform that will improve the access to health care and lower its cost, and eliminate some of the ongoing distortions in labor markets caused by cost shifting.

Most analysts agree that the burden of the current employer-based health care system is borne primarily by workers in the form of lower wages. Increases in health care costs in recent years have eaten into employee wages and other benefits (Figure 1). In fact, rising health care costs may help explain the decline in real wages over the same period. In addition to its impact on wages, the current health care system has contributed to a two-tier job market. To avoid incurring current and future health care obligations, many employers often hire new workers as temporaries or via temporary worker services. This has contributed to a significant increase in temporary workers, which can also take away from creating high performance workplaces.

The present system of rising, uncontrolled health care costs falls most heavily on large firms, many of which are strong exporters. Industries such as automobiles and chemical products spend more than twice the national average of health care costs per worker. Our analysis suggests that under the Clinton health care reform proposal, manufacturing industries would save almost $100 per worker, and up to $439 per worker in the top twenty exporters, as opposed to an average net cost per worker of $319 for all firms. However, the reform should improve the international trade component of America's competitiveness problem.

In broad economic terms, the Administration's reform proposal is projected to achieve a lower path of federal health spending in the long-run (despite a higher path in the short run) than the current course. It would thereby free up public resources for important public investments and/or lowering the federal deficit. The aggregate impact of reform should thus be favorable for the nation's competitiveness.

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Public Investment

Public investment in education and training, R&D and infrastructure amounted to 25 percent of non-defense outlays and 2.5 percent of GDP in 1965. By 1995, based on current budget projections, this public investment is expected to be only 11 percent of non-defense outlays and 1.9 percent of GDP (Figures 2 and 3). The Council reiterates the importance of education and training, R&D and public infrastructure in order to raise productivity growth and American living standards. The Council strongly supports the Clinton Administration in its efforts to increase federal investment but it urges the development of a more coherent investment plan. The Council calls on the Administration to establish an investment budget as a first step. This budget should set a target for total public investment which should be considered by the Congress.

Education and Training

In its Second Report, the Council called for establishing a system of life-long learning, including improving the nation's basic education, better facilitating the school-to-work transition, increasing job-related training, and expanding retraining programs for dislocated workers. The Council applauds the Administration and Congress for the passage and signing of Goals 2000, which takes the first step toward establishing rigorous content and performance standards for what students should know and be able to do as a result of their schooling. The Council is also

pleased that the Administration's school-to-work program, reflecting its Training Subcouncil recommendations, has also recently been passed and signed by the President.

In its Second Report, the Council also recommended that the government encourage firms to increase job-related training through grants, tax credits or payroll requirements. Unfortunately, the Administration has not yet put forward its proposal to promote greater job-based training and the Council encourages it to do soon.

The Administration's recent proposal to improve government programs designed to assist workers adjust to new economic realities reflects many of the Council's previous recommendations. Under the proposed Reemployment Act of 1994, individuals would be eligible for longer-term benefits. The Council is concerned that, by improving the quality of benefits, the Administration's program may limit the number of workers who might receive benefits. The Council urges the Administration and Congress to provide a guaranteed funding source to insure that adequate benefits are available for all those in need.

Critical Technologies

The Administration has begun to implement a new technology policy largely reflecting the Council's recommendations for shifting emphasis from defense to civilian R&D and focusing on projects which will promote commercial technologies. The Council urges the Congress to appropriate funds for programmatic increases in the President's budget request in FY 1995.

Given the discretionary spending caps enacted in the 1993 budget agreement, the President and Congress will need to maintain their commitments to this new technology policy in the FY 1996 and FY 1997 budgets. In addition, the government and private sector must work together to ensure that the new and expanded programs work as intended, and that they are evaluated and modified as necessary.

Public Infrastructure

The Council is encouraged by the positive attention given to investment in transportation infrastructure in the President's proposed FY 1995 budget. Recognizing the importance of public infrastructure in the national economy, the budget requests full funding of highway programs at the levels authorized in the Intermodal Surface Transportation Efficiency Act of 1991. The proposed increase in Amtrak's capital improvement funds is also long overdue.

Although the budget proposals for FY 1995 and beyond reflect a renewed attention to capital investment in infrastructure, the increases are barely large enough to make a dent in the decades-old deterioration of infrastructure. Chief among these problems is the practice of state and local officials of deferring maintenance on infrastructure to the indefinite future. The practice is so widespread that the category of "deferred maintenance" has taken on the connotation of an actual program item in state and local budgets. But deferred maintenance is not a program, it is a liability, and the public needs to be continually aware of the deferral of its responsibilities to maintain its own economic lifelines.

Trade Policy

The Administration, and in particular the Commerce Department, has made significant progress in coordinating export policy and removing disincentives to US exports, as called for in the Council's Second Report. The Council commends the Administration's recent decision to remove the requirement for advanced approval for virtually all civilian telecommunications and computers exports to China and the countries of the former Soviet Union. Although the Council's previous recommendation for a unified budget function has not yet been followed, the Office of Management and Budget has created a table of Export-Related Expenditures. We are encouraged by the prospect that a unified budget function may be employed in FY 1996.

The Council urges the Administration to submit legislation implementing the recently signed GATT agreement as soon as possible and urges the Congress to renew the President's trade negotiating authority (which expired on December 15) for new multilateral, regional and bilateral trade agreements.

Federal Budget

The discretionary spending caps enacted in 1990 and re-extended in 1993 have been a helpful management tool to Congress, but may have outlived their usefulness. If continued beyond FY 1995, these caps will require very large cuts from the budget baseline. Reducing the deficit does not require a freeze in discretionary spending. While the Council strongly reaffirms

the need to continue lowering the federal deficit, we believe that consideration should be given to amending the Budget Enforcement Act to permit entitlement cuts or revenue increases to be used to pay for increases in federal investment.

Competitiveness Impact Statements

Under the Omnibus Trade and Competitiveness Act of 1988, the President and heads of agencies are required to submit to Congress "Competitiveness Impact Statements" (CIS) along with all legislative proposals which may affect the ability of American firms to compete in international commerce. This law has been ignored over the last six years and is now about to expire. The Council recommends that the Congress renew the law, although limiting the requirement to prepare a CIS on just those new proposals deemed to have a significant impact on competitiveness, and assigning that responsibility to an independent agency like the US International Trade Commission or the Congressional Budget Office.

Council's Work Plan

The Council has expanded its work program into two new areas: capital allocation and social issues.

Capital Allocation

The Council has established a new subcouncil on Capital Allocation co-chaired by Robert Denham, Chairman of Salomon, Inc. and Michael Porter, a professor at the Harvard Business School. This subcouncil is taking a broad look at issues such as shareholder monitoring of boards of directors, employee and management ownership, and the debt bias of the tax code. It will be making recommendations to the full Council in early 1995.

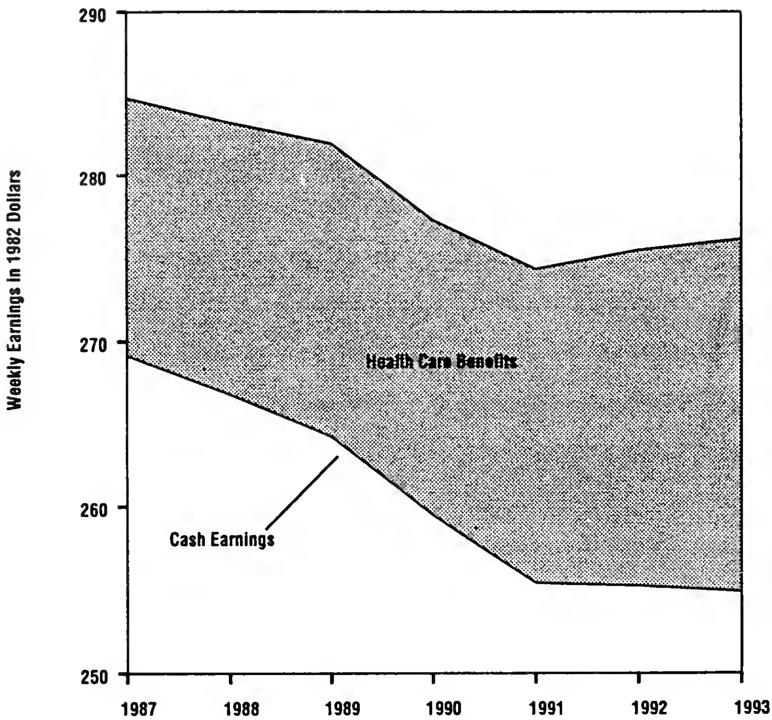
Social Issues

Social problems weaken American competitiveness, both now and in the future, in both obvious and subtle, by reducing the size of the workforce, reducing the skill level of the workforce, robbing the society of substantial public and private resources needed to pay the high price of crime and public assistance. America cannot realize its full economic potential if we abandon our disadvantaged populations. The Council will focus on the nexus of issues related to child readiness to learn, the effectiveness of pre-school and supplementary school programs, and youth dropout, unemployment and labor force participation rates.

Mr. Chairman, on behalf of the Council, I want to thank you for your support for the Council's efforts to educate the American public about competitiveness and to provide policy proposals to the Congress and the Administration.

Figure 1

Wages and Employer-Paid Health Insurance



Source: Bureau of Labor Statistics

Figure 2

Federal Non-Defense Investment

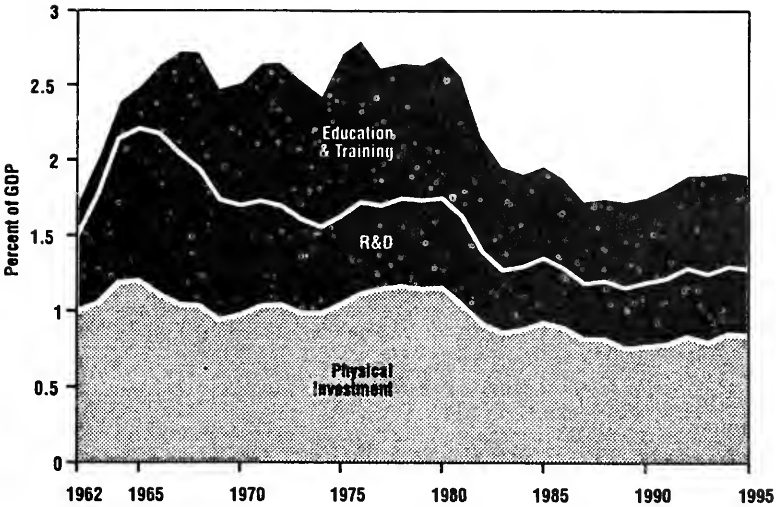
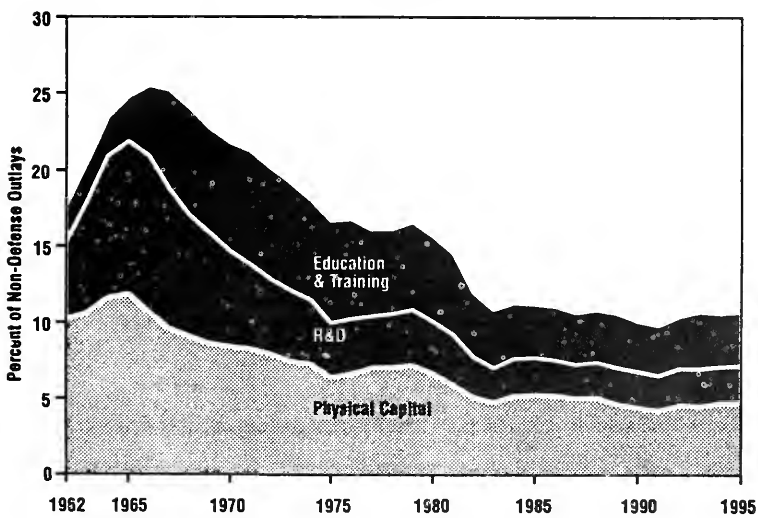


Figure 3



Source: Office of Management and Budget

COMPETITIVENESS POLICY COUNCIL

1726 M Street NW • Suite 300 • Washington, DC 20036 • Tel. (202) 632-1307 • FAX: (202) 632-1350

May 12, 1994

Contact: Howard Rosen (202) 632-1307

CURRENT RECOVERY NOT SUFFICIENT TO REVERSE LONG-TERM EROSION OF US COMPETITIVENESS

HEARINGS BEFORE SUBCOMMITTEE ON ECONOMIC GROWTH AND CREDIT FORMATION OF THE HOUSE BANKING, FINANCE AND URBAN AFFAIRS COMMITTEE: 2:00 pm, Room 2220 Rayburn House Office Building

EMBARGO; May 12, 1994, 2:00 pm, E.S.T.

Washington, May 12---The current economic recovery is encouraging but will not be enough to reverse the twenty year erosion in the nation's competitiveness, according to the Competitiveness Policy Council's Third Report to the President and Congress. In spite of the goods news about the economy, the Council remains concerned about the lack of improvement in several key economic fundamentals: America's saving rate remains the lowest among the industrialized countries and continues to fall, our students and workers continue to lag behind other countries in educational achievement and the nation's investment in plant and equipment, R&D and public infrastructure is insufficient. "Without improvement in these fundamentals, we cannot hope to translate the current pickup into long-term gains in our standard of living," the Report says.

The Competitiveness Policy Council is a twelve-member, bipartisan national commission created by Congress. It includes three corporate leaders, three labor union presidents, three senior government (federal and state) officials and three representatives of the public. The members were appointed by the President and by the joint leadership of the Senate and House of Representatives. The Council is chaired by Dr. C. Fred Bergsten, Director of the Institute for International Economics. President Clinton appointed Dr. Laura D'Andrea Tyson, Chair of the Council of Economic Advisers, as the federal government representative last September.

"Promoting Long-Term Prosperity" is the Council's third report to the President and Congress reviewing the state of US competitiveness and making policy recommendations on how to improve national living standards. In its first report, in 1992, the Council called for "a comprehensive competitiveness strategy" to address the steady erosion in the nation's competitiveness. In its second report, in 1993, the Council proposed national goals for saving, investment and economic growth aimed at doubling productivity growth by the end of the decade and presented detailed policy recommendations in the areas of capital formation, corporate governance and financial markets, critical technologies, education, manufacturing, public infrastructure, trade policy and training.

78-948 18

In this year's report, the Council reviews progress made during the first year of the Clinton Administration in implementing its initial proposals and suggests additional steps which need to be taken. In addressing the current debate over whether the United States still has a competitiveness "problem," the Council notes that in spite of the current improvements in economic growth, unemployment and inflation, there remains a stagnation or even decline in real wages and total compensation -- the best measures of a nation's standard of living. "Some people view the cyclical recovery in the United States and poor economic performance in Europe and Japan as indicators that we have solved our competitiveness problem," notes Dr. Bergsten, the Council's Chairman. "We reject such a narrow definition of competitiveness. America cannot be viewed as competitive as long as our standard of living fails to rise. In addition, we cannot ignore the fact that our trade deficit is soaring toward a record level."

In addition to reviewing recent development in technology, education and training and public infrastructure, the Council's new report focuses on the impact of health care reform on US competitiveness and the need for improvements in how the federal government budgets for investment. The Council also presents its future agenda in the area of capital allocation and social issues. The following are some highlights from the Council's 1994 report.

Health Care Reform

The nation currently spends 14 percent of GDP on health care, more than any other country in the world, yet this is no evidence that our citizens are that much healthier. The nation's current health care system affects our competitiveness in two major ways. First, growing health care inefficiency is diverting resources which could instead be invested in education, technology and infrastructure. Second, under our current system, workers pay the lion's share of the nation's health care bill through lower take-home wages and declining quality of health care.

In the short run, health care reform is likely to raise the federal deficit slightly higher than under the current system, further curtailing national saving. In the long run (after 2004), some of the plans being discussed, including the Administration's, could reduce the federal deficit below the current baseline and contribute to raising national saving and investment. In comparing reform alternatives, Congress and the American people should give more weight to the long-term implications than to the impact on the deficit over the next few years.

Most analysts now agree that the burden of the current employer-based health care system is borne primarily by workers in the form of lower wages. Increases in health care costs in recent years have eaten into employee wages and other benefits (Figure 1). In fact, rising health care costs may help explain much of the stagnation or decline in real wages over the same period. In addition to its impact on wages, the current health care system has contributed to a two-tier job market. To avoid incurring current and future health care obligations, many employers often hire new workers as temporaries or via temporary worker services. This has contributed to a significant increase in temporary workers, which can also take away from creating high performance workplaces.

The present system of rising, uncontrolled health care costs falls most heavily on large firms, many of which are strong exporters. Our analysis suggests that under the Clinton health care reform proposal, manufacturing industries would save almost $100 per worker, and up to $439 per worker in the top twenty exporters, as opposed to an average net cost per worker of $319 for all firms. However, the reform should improve the international trade component of America's competitiveness problem.

Public Investment

Public investment in education and training, R&D and infrastructure amounted to 25 percent of non-defense outlays and 2.5 percent of GDP in 1965. By 1995, based on current budget projections, this public investment is expected to be only 11 percent of non-defense outlays and 1.9 percent of GDP (See Figures 2 and 3). The Council reiterates the importance of public investment in education and training, R&D and public infrastructure in order to raise productivity growth and American living standards. The Council strongly supports the Clinton Administration in its efforts to increase federal investment but it urges the development of a more coherent investment plan. The Council calls on the Administration to establish an investment budget as a first step. The following are additional steps which need to be taken:

Federal Budget: The spending caps enacted in 1990 and re-extended in 1993 have been a helpful management tool to Congress but may have outlived their usefulness. If continued beyond FY 1995, these caps will require very large cuts from the budget baseline. But reducing the deficit does not require a freeze in discretionary spending. While the Council strongly reaffirms the need to continue lowering the federal deficit, we believe that consideration should be given to amending the Budget Enforcement Act to permit entitlement cuts or revenue increases to be used to pay for increases in federal investment.

Competitiveness Impact Statements: Under the Omnibus Trade and Competitiveness Act of 1988, the President and heads of agencies are required to submit to Congress "Competitiveness Impact Statements" (CIS) as part of all legislative proposals which may affect the ability of American firms to compete in international commerce. This law has been ignored over the last six years and is now about to expire. The Council recommends that the Congress renew the law, although limiting the requirement to prepare a CIS on only those proposals deemed to have a significant impact on competitiveness, and assigning that responsibility to an independent agency like the US International Trade Commission or the Congressional Budget Office.

Education and Training

In its Second Report, the Council called for establishing a system of life-long learning, including improving the nation's basic education, better facilitating the school-to-work transition, increasing job-related training, and expanding retraining programs for dislocated workers. The Council applauds the Administration and Congress for the passage and signing of Goals 2000, which takes the first step toward establishing rigorous content and performance standards for what students should know and be able to do as a result of their schooling. The Council is also pleased that the Administration's school-to-work program, reflecting its Training Subcouncil recommendations, has also recently been passed and signed by the President.

In its Second Report, the Council also recommended that the government encourage firms to increase job-related training through grants, tax credits or payroll requirements. Unfortunately, the Administration has not yet put forward its proposal to promote greater job-based training and the Council encourages it to do soon.

The Administration's recent proposal to improve government programs designed to assist workers adjust to new economic realities reflects many of the Council's previous recommendations. Under the proposed Reemployment Act of 1994, individuals would be eligible for longer-term benefits. The Council is concerned that, by improving the quality of benefits, the Administration's program may limit the number of workers who might receive benefits. The Council urges the Administration and Congress to provide a guaranteed funding source to insure that adequate benefits are available for all those in need.

Critical Technologies

The Administration has begun to implement a new technology policy largely reflecting the Council's recommendations for shifting emphasis from defense to civilian R&D and focusing on projects which will promote commercial technologies. The Council urges the Congress to appropriate funds for programmatic increases in the President's budget request in FY 1995. Given the caps enacted in the 1993 budget agreement, the President and Congress will need to maintain their commitments to this new technology policy in the FY 1996 and FY 1997 budgets. In addition, the government and private sector must work together to ensure that the new and expanded programs work as intended, and that they are evaluated and modified as necessary.

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Although the budget proposals for FY 1995 and beyond reflect a renewed attention to capital investment in infrastructure, the increases are barely large enough to make a dent in the decades-old deterioration of infrastructure. Chief among these problems is the practice of state and local officials of deferring maintenance on infrastructure to the indefinite future. The practice is so widespread that the category of "deferred maintenance" has taken on the connotation of an actual program item in state and local budgets. But deferred maintenance is not a program, it is a liability, and the public needs to be continually aware of the deferral of its responsibilities to maintain its own economic lifelines.

Trade Policy

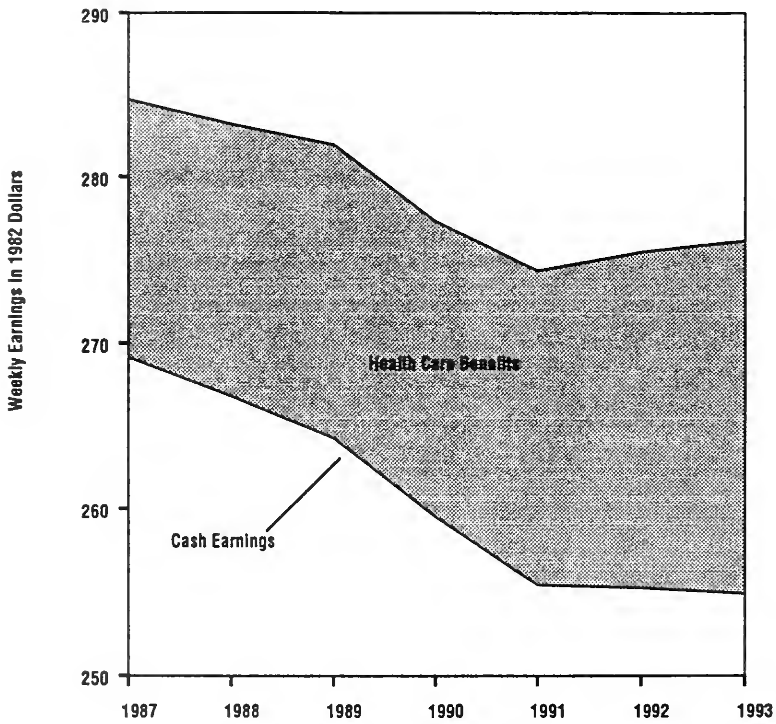
The Administration, and in particular the Commerce Department, has made significant progress in coordinating export policy and removing disincentives to US exports, as called for in the Council's Second Report. The Council commends the Administration's recent decision to remove the requirement for advanced approval for virtually all civilian telecommunications and computers exports to China and the countries of the former Soviet Union. Although the Council's previous recommendation for a unified budget function has not yet been followed, the Office of Management and Budget has created a table of Export-Related Expenditures. We are encouraged by the prospect that a unified budget function may be employed in FY 1996.

The Council urges the Administration to submit legislation implementing the recently signed GATT agreement as soon as possible and urges the Congress to renew the President's trade negotiating authority (which expired on December 15) for new multilateral, regional and bilateral trade agreements.

The Council's Third Report, "Promoting Long Term Prosperity" is available from the Government Printing Office. Copies of other reports and commissioned studies are available from the Council.

Figure 1

Wages and Employer-Paid Health Insurance



Source: Bureau of Labor Statistics

Figure 2

Federal Non-Defense Investment

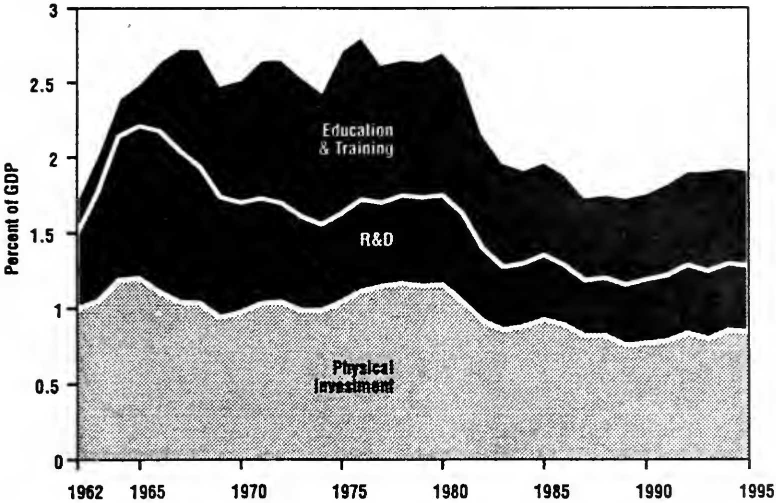
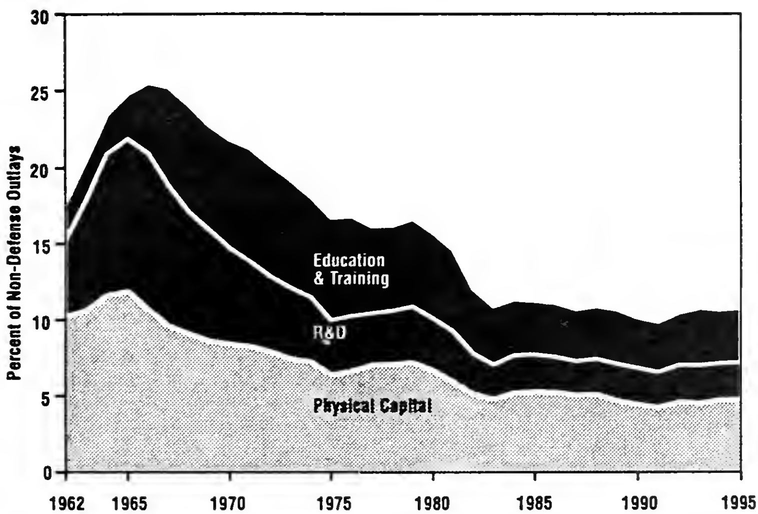


Figure 3



Source: Office of Management and Budget

PROMOTING LONG-TERM PROSPERITY

THIRD REPORT TO
THE PRESIDENT
AND CONGRESS

MAY 1994

Competitiveness Policy Council

Appointed by the President

Albert Shanker *(Labor)**
President
American Federation of Teachers

Alexander Trowbridge *(Business)**
President
Trowbridge Partners

Laura D'Andrea Tyson *(Government)*
Chair
Council of Economic Advisers

Edward O. Vetter *(Public Interest)**
President
Edward O. Vetter and Associates

*appointed by President Bush

Appointed by the Bipartisan Leadership of the US Senate

Rand V. Araskog *(Business)*
Chairman and CEO
ITT Corporation

John Barry *(Labor)*
President
International Brotherhood
of Electrical Workers

William Graves *(Government)*
Secretary of State, State of Kansas

Bruce Scott *(Public Interest)*
Professor of Business Administration
Harvard Business School

Appointed by the Bipartisan Leadership of the US House Representatives

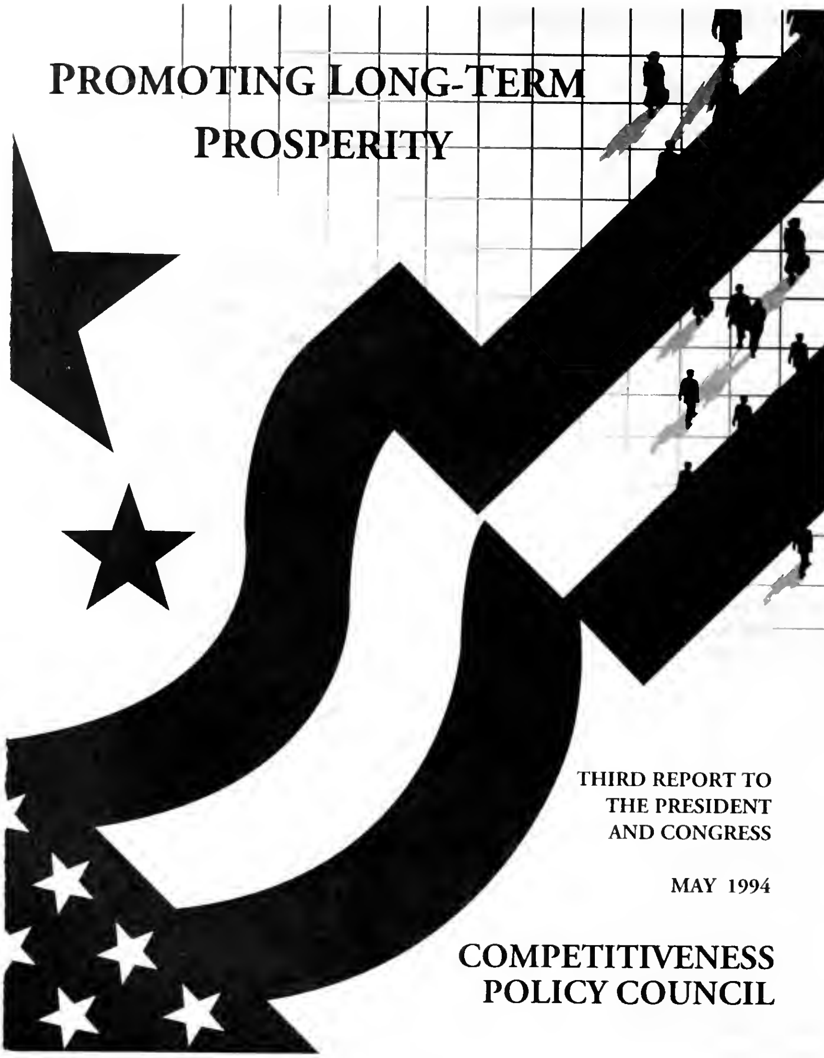
C. Fred Bergsten, Chairman
(Public Interest)
Director
Institute for International Economics

John J. Murphy *(Business)*
Chairman and CEO
Dresser Industries, Inc.

Edward V. Regan *(Government)*
Former Comptroller
State of New York

Lynn R. Williams *(Labor)*
Retired President
United Steelworkers of America

PROMOTING LONG-TERM PROSPERITY



THIRD REPORT TO
THE PRESIDENT
AND CONGRESS

MAY 1994

COMPETITIVENESS POLICY COUNCIL

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Competitiveness Policy Council

Washington, DC

May 1, 1994

Honorable William J. Clinton
President of the United States
The White House
Washington, DC 20500

Dear Mr. President:

The Competitiveness Policy Council is pleased to deliver its Third Report to the President and Congress. In it we discuss the current state of US competitiveness and make recommendations for needed policy changes.

In its first report, the Council called for a comprehensive strategy to address the steady erosion in America's competitiveness. In its second report, the Council presented detailed policy recommendations in the areas of capital formation, corporate governance and financial markets, critical technologies, education, manufacturing, public infrastructure, trade policy and training. During the past year, we have focused on key specific policy issues and how they relate to US competitiveness, and have worked with the Administration and Congress in seeking implementation of the Council's previous recommendations.

In addition to commenting on recent developments in education, training, technology, public infrastructure and trade policy, this year's report focuses on the impact of health care reform on the nation's competitiveness and ways of improving how the government budgets for public investment.

The Report represents a consensus of the Council members though not every member agrees with every word in the text. The Council members have been appointed as individuals and their concurrence in this report does not necessarily reflect the position of the institutions with which they are associated.

Honorable William J. Clinton
Page 2

The Competitiveness Policy Council is a 12-member federal advisory committee with representatives from business, labor, government (both state and federal) and the public. The group is comprised equally of Democrats and Republicans. All of our meetings are open to the public. One-third of our members were appointed by the President, one-third by the Speaker and the Minority Leader of the US House of Representatives acting jointly, and one-third by the Majority and Minority Leaders of the US Senate acting jointly. The Omnibus Trade and Competitiveness Act of 1988 (P.L. 100-418), as amended by the Customs and Trade Act of 1990 (P.L. 101-382), created the Council "to develop recommendations for national strategies and on specific policies intended to enhance the productivity and international competitiveness of United States industries."

We look forward to discussing the findings and recommendations of this report with you as we all seek to build a more competitive nation.

Sincerely,

C. Fred Bergsten

C. Fred Bergsten
Chairman

Enclosure

NOTE: Identical letters were sent to Albert Gore, Jr., President of the Senate, and Thomas S. Foley, Speaker of the House of Representatives.

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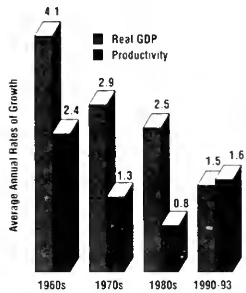
Introduction

The latest news about the US economy is encouraging. But its recent strength is not enough to reverse the long run erosion in the nation's competitiveness — defined as our standard of living. There has been improvement in some of the macroeconomic indicators but little progress is evident in many of the underlying economic fundamentals that are critical to improving our competitiveness: saving and investment, research and development, and education and training. Without improvement in these fundamentals, we are unlikely to translate the current pickup into long-term gains in our standard of living.

On the other hand, the current environment provides a good framework from which to attack our long-run needs. Between 1972 and 1987, after taking cyclical factors into account, productivity grew by only 1.3 percent per year, compared with an average of 2.5 percent during the previous twenty years. Between 1987 and 1993 productivity growth was still only 1.2 percent per year.[1] The higher numbers in the early 1990s are largely due to the normal productivity recovery from the recession. As the Council indicated in its First Report in 1992, high productivity and economic growth rates are critical ingredients for enhancing our competitiveness. In order to improve our standard of living we need to restore the productivity growth rates that we experienced prior to 1973. [Figure 1]

Productivity growth is a necessary, but not sufficient, condition for improving US competitiveness. Higher economic growth is needed to reemploy the human resources freed up by increased productivity. Accordingly, the Council set a sec-

Figure 1
Growth of GDP and Productivity



Source: Department of Commerce

ond goal of achieving a lasting growth rate of 3 to 3.5 percent for the overall economy by the end of the decade. The US economy surpassed this target in 1993, posting 4 percent growth. In response, unemployment, which has been too high for too long, fell from 7.7 percent in June 1992 to 6.4 percent by the end of 1993. This pickup in economic growth in 1993 was highly welcome.

But we are doubtful that such rapid growth can be maintained. Although net private investment moved up slightly to 4 percent of gross domestic product (GDP) in 1993, it is still well below its 1973 level of 8 percent of GDP and continues to be the lowest of all the industrialized nations. Investment in plant and equipment, which has

The "Competitiveness" Debate

In its First Report to the President and Congress, the Council defined competitiveness as the "ability to produce goods and services that meet the test of international markets while our citizens earn a standard of living that is both rising and sustainable over the long run." The Council has consistently relied upon this broad definition, as opposed to more narrow ones based on the trade deficit or market shares that are used by others. Nations are not corporations and thus cannot be judged in the same manner. A nation's primary economic objective is to provide a rising standard of living for all its citizens.

Increasing economic integration has made national economies more interdependent. In spite of this increased economic integration, improvement in our competitiveness need not come at the expense of others. On the contrary, nations can raise their living standards simultaneously, just as occurred during the 1950s and 1960s. The global economy serves as the source of future economic growth.

Productivity growth is the key to long-term improvement in our standard of living. Investment in plant and equipment, R&D and infrastructure, and education and training are critical ingredients to improving productivity growth. Earning the resources with which to make these Investment, rather than borrowing them, will insure that the resulting increases in living standards are sustainable over the long term.

the highest payout in terms of productivity, also remained relatively flat at 9 percent of GDP in 1993, its lowest level in over 30 years. The Council calculates that national investment would have to increase by at least 4 to 6 percentage points of GDP, or about $300 billion annually at current prices, for the economy to achieve our ambitious productivity target and thus maintain growth at 3 to 3.5 percent per year.

In order to finance the needed increase in national investment without additional foreign borrowing, the national saving rate would have to rise by 5 to 7 percentage points of GDP, restoring national saving to the level that prevailed prior to 1973. One of the most troubling developments in 1993 was that net national saving (gross saving minus federal and state government deficits) fell to 1.5 percent of net national product (NNP), continuing its downward trend from 11 percent of NNP in 1973. [Figure 2]

This fall in net national saving occurred in spite of the Administration's success in securing Congressional approval of a five-year budget reduction package. The Congressional Budget Office (CBO) recently reported that, due in large part to the agreed package, the federal budget deficit is expected to fall to approximately 2.5 percent of GDP by 1998, down from close to 5 percent of GDP in 1992. [Figure 3] This is a substantial move in the right direction but is only half way to eliminating the deficit. Under current policies, moreover, the budget deficit is expected to begin increasing again after 1999.

Total private saving fell one percentage point of NNP, caused in large part by a large drop in household saving from a peak of 7 percent of NNP in 1973 to a historic low of 3 percent of NNP in 1993.[2] As the Council noted last year, increases in private saving, while desirable, are extremely difficult to engender; thus most of the improvement in nation-

Figure 2
US National Saving

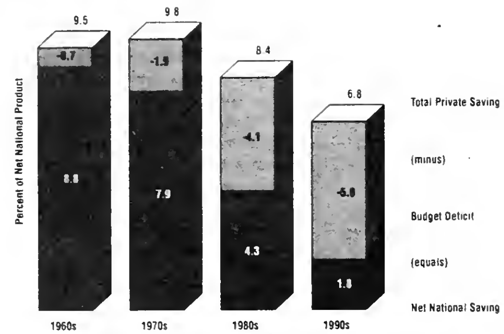
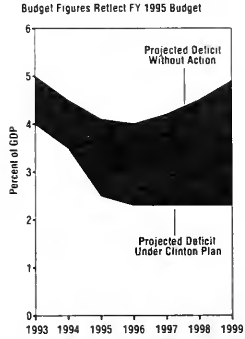
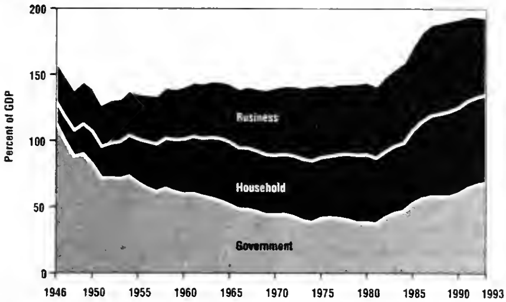


Figure 3
Deficit Reduction Under the Clinton Plan



Source: Office of Management and Budget and Congressional Budget Office

Figure 4
Level and Composition of US Debt



Source: Federal Reserve System

al saving will have to come from correcting the federal budget deficit.

Increases in public and private saving are critical to achieving a sustainable improvement in our living standards. Economic improvements built on debt-financed consumption will not translate into permanent gains for all Americans. Aggregate non-financial debt is close to twice the nation's GDP, higher than any time since the Second World War. [Figure 4] In spite of the fact that the economy has been improving, government and household debt has continued to grow to record levels. Business debt has returned to its mid-1980s level, but remains at almost 60 percent of GDP. The only way we can hope to achieve lasting improvements in our economy is to *earn* our standard of living, through domestic saving and investment, and not continue to borrow, as we have been doing since 1980.

The recent upturn in the economy camouflages another troubling development. The widely cited economic indicators report national averages which do not correspond to individual experience. The Council is concerned about raising living standards for *all* groups of Americans. While average personal income has been rising, the percentage of people living below the poverty line has been increasing. Furthermore, the average annual growth of mean family income has been falling in the lowest two quintiles, basically constant in the third quintile, and has been rising only in the top two quintiles. The worsening distribution of income is not only a manifestation of our competitiveness problem but also contributes to many of the problems plaguing our society today.
More job creation and investment in education and job training are necessary to help American workers achieve rising living standards.

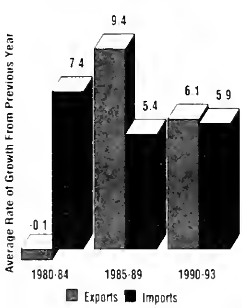
How is the United States Performing Relative to Others?

When looking at US competitiveness relative to our major trading partners, the most relevant measure of comparison is productivity growth. While the United States remains the most efficient economy in the world, the gap between the United States and the other industrialized countries is closing. Productivity growth rates in Japan and Germany have tended to be above those for the United States until recently.

However, productivity growth in Germany fell to almost zero and in Japan actually fell to below zero in 1992. Japan, correcting for its investment bubble in the 1980s and having failed to take the necessary expansionary measures, experienced

a decline of half a percent of GDP in 1993. Germany, which has yet to fully adjust to the challenges of unification and new realities in the international economy, experienced a decline of 1.5 percent of GDP in 1993. In turn, the US merchandise trade deficit expanded by 40 percent, reaching approximately $132 billion in 1993, and causing the current account deficit to grow to $109 billion. Export growth fell to 2 percent, primarily due to slow growth in the industrialized countries, and imports grew by 8 percent, reflecting the economic recovery here in the United States. [Figure 5] A steady strengthening of the dollar against all major currencies except the yen will further exacerbate the deterioration of the US trade deficit.

Figure 5
Export and Import Growth Rates



The fact that the US economy outperformed Germany and Japan in 1993 has led some observers to suggest that the United States has solved its competitiveness problem. The Council does not share this optimism predicated upon a narrow view of competitiveness. We should not take comfort from the fact that other nations are performing worse economically than the United States. Nations can and should seek to raise their living standards simultaneously, as was the case for most of the period following World War II. Furthermore, declines in European or Japanese growth rates do not imply that the US economy is operating more efficiently. The best measure of our nation's ability to compete is our ability to maintain rising living standards here at home. Strong growth abroad is necessary in order for US producers to sell their products and hence boost US income.

Between 1870 and 1973, real per capita income in the United States grew at an average of 1.9 percent per year, enabling incomes to double every thirty-two years. US living standards in 1973, measured by real income, were ten times greater than they were a century earlier. At the current anaemic growth rate of 3 percent per year between 1973 and 1993, it will take another fifty-five

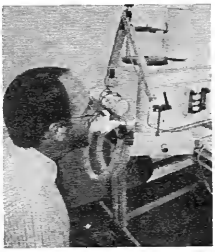
> **"The key to stemming the erosion of US competitiveness lies with reversing recent trends in long-run economic fundamentals. Although the current economic recovery does not in itself achieve this, it does provide an excellent opportunity to act decisively in shifting national priorities toward investing in human and physical capital."**

years, until the year 2050, to double current incomes. The key to stemming the erosion of US competitiveness lies with reversing recent trends in long-run economic fundamentals. Although the current economic recovery does not in itself achieve this, it does provide an excellent opportunity to act decisively in shifting national priorities toward investing in human and physical capital. It is precisely during times of economic growth that we should begin saving and investing for the future.

The Council's Role

The Competitiveness Policy Council was established by Congress in 1988 to address the long run decline in the nation's standard of living. The Council brings together representatives of business, government, labor, and the public — both Democrats and Republicans — to analyze the causes of the erosion in our competitiveness and to make recommendations to reverse this trend. In its First Report to the President and Congress, issued in 1992, the Council stated that "America's economic competitiveness ... is eroding slowly but steadily in spite of the fact that the United States continues to maintain the highest living standards and levels of productivity in the world." In its initial report, the Council identified six issues relating to improving US competitiveness deserving of priority attention: saving and investment, education, technology, corporate governance and financial markets, health care costs and trade policy. In 1993, the Council presented detailed recommendations in each of these areas. Many of these recommendations, especially in the areas of technology, trade policy, education and worker training, have already been adopted by the Clinton Administration and enacted by the Congress. This year's report focuses on the implications for America's competitiveness of health care reform, public investment in technology, education, training, and infrastructure and trade policy. This report also outlines our recommendations on investment budgeting and our current work program in the areas of capital allocation and social issues.

Health Care Reform and US Competitiveness



As a sector responsible for 14 percent of GDP, health care influences every aspect of the US economy. Accordingly, in its First Report, the Council identified health care reform as an area deserving priority attention. Because of its enormous and growing impact on the economy and the federal budget, the Council concluded that the "national objective should be the achievement of world-class health care for all Americans at a cost to the economy that is comparable to other major industrial countries."[3] Given the rapidly shifting nature of the policy discussion, the Council decided to defer its consideration until the Administration's reform proposal and other detailed proposals were was presented for policy debate. [4]

The Council is interested in the impact of health care reform on the economy as a whole as well as on the labor market, the trade balance, and particular industries. Each of these is discussed below.[5]

Health Care and the Economy

Health care costs in the United States are higher and are rising more rapidly than in all of our major trading partners. Unfortunately, there is no evidence that our citizens are commensurately healthier. Although there is no apparent relationship between health care expenditures and predicted life expectancy among the industrialized countries, the United States is a clear outlier with extremely high health care expenditures and lower than average predicted life expectancy.[6]

This leads the Council to believe that health care costs are diverting resources from other parts of the private economy where they could be used more productively and thereby improve the overall competitiveness of the country. In the absence of reform, the health share of GDP is projected to rise from its current 14 percent level to around 17 percent in 2000. None of the reform proposals being discussed, including the Administration's, promise to freeze the current share of GDP devoted to health care. They would only slow the rate of growth beginning in 2000, resulting in a lower health share of GDP after 2000 than would occur under present law. This would be a significant achievement, but the Council believes that the nation may eventually have to aim to *reduce* the share of GDP devoted to health care. In addition, all budget estimates on health care reform are subject to a great degree of uncertainty.

Evaluating the impact of health care reform requires a consideration of both the short term and the long term. In the short term, the federal deficit is likely to rise slightly higher with reform than it would under current law. This could further reduce national saving. In the long run (after 2004), the various plans being discussed aim to reduce the federal deficit below the current-law baseline and contribute to raising national saving and investment. As we stated in our First and Second Reports, federal policy often has a built-in bias against long run considerations. For health care reform, we believe that the proper target is getting control of the system's costs over the long run. Therefore, in comparing reform alternatives, Congress and the American people should give more weight to the long term deficit implications than to the impact on the deficit over the next few years.

If health care costs were frozen at approximately the current level of spending, averting a projected increase to 16 percent of GDP by 1997, $125 billion (in 1997 dollars) could be redeployed to non-health purposes. Such a reduction in projected health care spending would not change national income but the "reform dividend" could have a significant positive effect on competitiveness, depending on the extent to which the freed-up resources were reallocated to productivity-enhancing investment. Companies could invest some of their reform dividend in research, while individuals could devote some of their ensuing higher wages to personal saving. The reduction in the share of employee compensation attributed to health care could be matched by an increase in the share going to pensions, further increasing national saving. Lower federal spending on health could enable the federal government to reduce the deficit, leading to a further improvement in national saving. Lower health care costs could also make the United States more attractive to job-creating foreign investors.[7]

In the absence of changes in individual saving, business investment, or government dissaving, large effects on competitiveness cannot be anticipated. But the way in which the reform is carried out could lead to some effects on competitiveness.

Given the large size of the health care sector, even small effects can be significant when amplified across the economy.

Health Care and the Labor Market

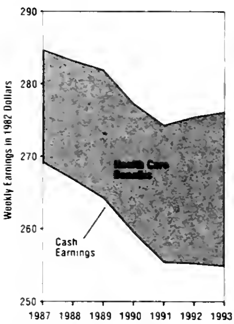
The biggest stake workers have in health care reform is in gaining access to quality health care. There is enormous benefit to such health security, both to workers and to the long-term efficiency and flexibility of the US economy as a result of the greater mobility of workers no longer dependent on their current employers for health care benefits. The Administration and Congress need to ensure that any further health insurance subsidies provided for low-income individuals do not create new disincentives preventing the poor from taking jobs.

If the rate of increase in total health costs is reined in, workers will also benefit as consumers. Health care reform may also permit unionized workers and management to shift their focus to other workplace issues; disputes over health care benefits have been a leading cause of labor-management disputes and strikes.

Most analysts now agree that the burden of the current employer-based health care system is borne primarily by workers in the form of lower wages. Increases in health care costs in recent years have eaten into employee wages and other benefits.[5] In fact, rising health care costs in recent years may help explain some of the decline in real wages over the same period. Had employer spending on health care been considered as "imputed income," the fall in cash earnings would not have been as steep. [Figure 6]

In addition to its impact on wages, the current health care system has contributed to a two-tier job market. While employers are not currently required to provide health insurance, many do. To avoid incurring greater costs, employers sometimes hire new workers as temporaries or via temporary worker services to avoid incurring current and future health care obligations. The increased use of temporary workers can be a result of many factors, such as industry restructuring, a desire for more flexible work teams or the choice of individuals who do not wish to work full time. But to the extent that health insurance plays a role, the reliance on temporary workers is a negative factor for the labor market as a whole. In addition to working with little security and few benefits, temporary workers often do not receive adequate training, are not fully integrated into the workplace, and therefore are not able to contribute fully. A national workplace distorted by the health insurance system cannot meet high performance standards.

Figure 6
Cash Earnings and Employer-Paid Health Care Benefits



The health care system may also exacerbate problems with the current welfare system. Under the existing system, some low-income individuals may face a perverse disincentive, preventing them from taking a job lest they lose their Medicaid benefits. According to the CBO, the Administration's proposal is projected to increase the labor force participation of welfare recipients. Such a "liberating" effect could assist in the welfare reform process. On the other hand, an

employer mandate, by raising labor costs (at least temporarily), could reduce the demand for workers.

The current health system causes large cost shifting. The firms that provide health insurance pay not only for their workers, but often also for spouses working elsewhere without health insurance. In addition, small companies that provide insurance may pay very high rates due to the absence of community rating. Both forms of cost shifting may distort competitiveness in favor of firms that do not pay health care costs. Thus, the current situation is unsustainable.

Reform of the magnitude needed will certainly have an impact on health care-related industries, for example, the health care equipment and pharmaceutical industries, which are among the strongest export industries. The Council believes that the competitiveness impact of systemic reform on the health care industry should also be considered.

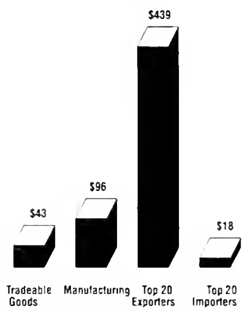
Health Care and International Trade

The effect of health care reform on international trade will occur mainly through its effect on federal spending and national saving. If health reform prevents the budget deficit from rising in future years, that will boost saving and should improve the balance of trade. If, as analysis suggests, increases in health care costs are borne primarily by workers, then U.S. exports do not carry a higher price due to health care costs.[9]

In addition to any overall effect on the trade deficit, the composition of the economy and trade could change under reform. The present system of rising, uncontrolled health care costs falls most heavily on large firms, many of which are strong exporters. Industries such as mining, primary metal, transport equipment, chemical products and petroleum products spend more than twice the national average of health care costs per worker.[10] Reform of our current health care system could help ease the burden being placed on these industries.

Most of the cost savings resulting from reform are concentrated in the top twenty export industries, where firms could gain an average of $439 per worker. Manufacturers that currently offer insurance would gain an average of $263 per worker, as many of these industries already provide health care coverage both to their own workers and to their workers' relatives who are not covered by smaller employers. Manufacturing firms which do not currently insure their workers will have to pay an additional $1,726 per worker. This is compared to the average net cost per worker for all firms, which is estimated to be $319.[11] It is not clear what effect health reform will have on health-care related export industries such as equipment and pharmaceuticals which may benefit from the increasing spending on health services and may be hurt by utilization controls. Import-sensitive industries are expected to experience a modest cost saving under the Administration's plan. [Figure 7]

Figure 7
Net Savings Per Worker Under Health Care Reform



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Council's Observations

Although the Council has not taken a position on pending health care bills, there are several points that it wants to make about the current debate.

First, the Council supports the availability of affordable high quality medical services for all Americans. The current system whereby some people cannot obtain coverage has negative economic, health, and social implications. Any serious health care reform must address the problem of cost shifting and aim toward a more equitable distribution of the costs of providing health care for all our citizens.

Second, many of the reform proposals, including the Administration's, are projected to achieve a lower growth path of federal health spending in the long run (despite a higher path in the short run) than the current course. Cost containment through efficiency gains and true cost reductions, while preserving the ability of the industry to continue innovating, is key to insuring that reform does not come at the expense of our competitiveness. By better controlling the share of government spending going to health, the reform would free up public resources for important public investments and/or lowering the federal deficit. Either of these outcomes would contribute to American competitiveness.

Third, the current health care system is not a static entity. Too many analysts assume that the features that they like about the current system are fixed and therefore find fault with some features of the Administration's reform model. The public should compare the various reform plans not to the current system but rather to what the current system will evolve into if left unmanaged. The problem of medical overspending and inflation is a national problem requiring a national solution. At present, employers who do provide health insurance have to spend an inordinate amount of time trying to reduce their costs to the extent possible.[12] Many employers have cut back health services and without reform more will do so. The Council does not believe that the present system can cure itself without changes in the law.

Fourth, the Council has adopted no position on whether employers should be required to pay a portion of wages or salaries in the form of health care, but we are very troubled with the current system whereby some employers provide health care and others do not. This leads to distortions in our labor market, the structure of our economy, and our medical system. Ultimately it is the worker who pays for most of the health care system, through lower wages and the quality of health care

"Health care costs are diverting resources from other parts of the private economy where they could be used more productively and thereby improve the overall competitiveness of the country."

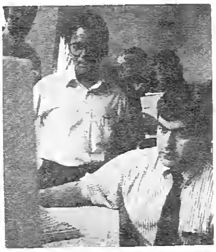
received, and thus the competitiveness concerns over an employer mandate may be exaggerated.[13] Many of the large companies involved in the tradeable goods sector are already providing health care to their employees. An employer mandate would not hurt these companies; indeed it might help iron out some of the distortions which disadvantage these companies and may reduce future costs of providing health care insurance.[14]

Mandating firms which do not currently provide health care coverage may result in some short-run effects for these firms, but these can be softened in a variety of ways. Thus, the Council believes that the proposal for an employer mandate should be decided on other grounds such as practicality, equity, ease of administration, and most importantly, its contribution to improving productivity and U.S. living standards. An employer mandate should not necessarily hurt our firms as they compete in international markets.

Fifth, the Council is concerned about proposals which would treat small and large firms differently. Government policies should avoid creating incentives for firms to be small, stay small or become small. Of course, the current system puts many small firms that provide health benefits at a disadvantage relative to larger firms because the costs per worker are disproportionately large due to the absence of large group rates.

Sixth, the Council believes that whatever financing system is chosen should attempt to improve access and utilization of preventative health care services. By employing more cost effective preventative measures, we can avoid higher costs of treating illnesses. In spite of this, childhood immunization rates for certain diseases have actually fallen in recent years. A significant part of our current health care expenditures are directly affected by drug abuse, smoking, violence, AIDS, teen-age pregnancies, premature births and other life-style and behavioral issues. Ultimately, preventative health measures can go a long way toward achieving the difficult goal of containing costs.

Education and Training



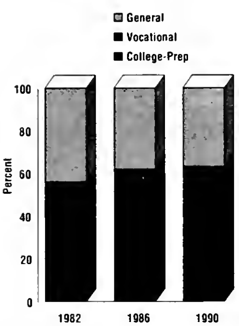
The US economy has proven to be significantly more successful than other industrialized countries in creating jobs. The United States created over 40 million jobs over the past twenty years. Most of these new jobs were filled by new entrants into the labor force, including women, immigrants and members of the baby-boom generation. This enormous growth in jobs was also accompanied by changes in the composition and structure of employment in the United States. Virtually all of the new jobs created over the last twenty years were in the service sector (96 percent). In fact, employment in the service sector almost doubled from 47 million

in 1970 to 88 million in 1993, while manufacturing employment declined from 19.4 million to 17.7 million over the same period. At the same time that the economy was creating jobs in order to absorb these new entrants into the labor market, real wages for production workers actually declined. Real average wages were $254.66 per week in 1993, 24 percent below their 1973 level of $315.38 per year.[15]

The United States has an enviable track record in job creation and absorbing new entrants into the labor force. But the economy has difficulty assisting people move from one job to another. Structural change, defense conversion, and trade liberalization have resulted in large numbers of dislocated workers over the past two decades. The high cost of moving these workers into more productive and growing sectors in the economy places large burdens on workers and communities. A flexible labor market benefits the economy as a whole, but we cannot ignore the costs which may result from such flexibility. The challenge is to preserve the benefits for the many without ignoring the costs to the few. If our aim is to improve the living standards, we must be concerned with the quality, as well as the quantity, of the jobs we create. In addition to creating high productivity, high income jobs, we must also make the proper investment to prepare our workers so that they can perform well in them.

The Council made a series of recommendations in its 1993 Report to improve the competitiveness of the US labor market within the context of a system of life-long learning. There are four major aspects: basic education, school-to-work transition, active worker training and reemployment of dislocated workers. Each builds upon the others. Our ability to train students and workers for high skilled jobs depends on a solid foundation of basic education. Devoting additional resources to worker training will only be effectacious if we improve the quality of our basic education system.

Figure 8
Composition of the Student Body



Source: Department of Education

Basic Education

President Clinton recently signed Goals 2000: Educate America Act, which establishes eight national education goals (see box) and a process for stimulating the nation, states and localities to achieve these goals. The Act codifies a bipartisan National Educational Goals Panel (NEGP) responsible for building a national consensus for improvement in education, reporting on progress made in reaching the goals, and reviewing standards and assessment criteria. It also establishes a National Education Standards and Improvement Council (NESIC) responsible for certifying national content, student performance and opportunity-to-learn standards. All these standards are voluntary; states may adopt NESIC-certified standards, submit their own standards for certification, or choose not to submit their standards to the NESIC. However, in order to receive some of the $400 million in Goals 2000 school improvement funds, states must submit plans to the Secretary of Education that address content and student performance standards and opportunity-to-learn strategies based on those standards.

Also included in the Act is the creation of a National Skill Standards Board made up of business, labor, education and training, government and community representatives. This Board is charged with developing a framework for a national system of voluntary standards for the knowledge and skills needed to perform successfully in the workplace.

As we noted in our Second Report, improving the education system must begin with the establishment of rigorous standards for what students should know and be able to do as a result of their schooling — standards for academic content and student performance. The Council therefore applauds passage of Goals 2000 in accordance with the recommendation included in its Second Report. Expectations must change from minimum competency to high achievement both for students who go on to college and for those who go directly to work. We strongly urge all states and local school districts to adopt the National Education Goals and to use them as the basis for curriculum and assessment, textbook and other materials adoption, teacher licensing and professional development requirements and accountability systems.

We also strongly urge that NESIC adopt a rigorous standards-certification process, that states either adopt those standards or submit their own standards to NESIC, and that the quality of this process and its effects on improving education be monitored.

National Education Goals

Goals 2000 had its origins in a meeting of the nation's governors convened in September 1989. In March 1990, President Bush and the governors announced eight education goals for the year 2000 and created an Education Goals Panel to develop indicators for measuring progress and issue an annual report card on the nation's progress in meeting the goals. The eight national education goals included in the bill signed by President Clinton prescribe that by 2000:

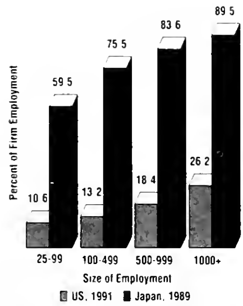
- All children will start school ready to learn.
- At least 90 percent of students will finish high school.
- Students will leave grades four, eight and twelve with demonstrated competence in English, math, science, foreign languages, civics and government, economics, arts, history and geography.
- Teachers will have access to programs for the continued improvement of their skills.
- The United States will be first in the world in math and science achievement.
- Every adult will be literate and possess the skills to compete in a global economy.
- Every school will be free of drugs and violence.
- Every school will promote involvement of parents in their children's education.

School-to-Work

President Clinton also recently signed the School-to-Work Opportunities Act, which reflects many of the Council's recommendations in this area. The Act provides $300 million in FY 1995 as seed money to states and local school systems to develop school-to-work transition programs. Aimed squarely at reclaiming the "forgotten half" of American youth who do not go on to college [Figure 8], the initiative includes many of the elements that the Council recommended as essential components: mentorship and jobs provided by employers, integration of academic and vocational learning; provision of wages to protect against exploitation of student workers, and provision of certificates of occupational skill

mastery upon completion. Particularly gratifying is the spread of interest in this program on the part of an increasing number of states which are developing their own approaches, including apprenticeships, tech-prep education, cooperative education, and career academies. The Council applauds the cooperative efforts of the Departments of Labor and Education in making $100 million in funds available this fiscal year for the program and in working cooperatively to move this initiative forward.

Figure 9
Private Sector Training



Training

Active worker training is the one area within labor market policies in which the United States lags behind and there has been no progress. [Figure 9] During the campaign, President Clinton suggested a "play or pay" scheme, which would have required firms to spend at least 1.5 percent of payroll on training of active workers, or else pay that amount into a government training fund. Concern from the business community caused the Administration to back off from this proposal. In its Second Report, the Council recommended that the government encourage firms to increase job-related training through grants, tax credits or payroll requirements. The Administration has not yet put forward its proposal to promote greater job-based training, and the Council encourages it to do so soon.

Reemployment of Dislocated Workers

The Administration recently proposed to overhaul the nation's programs for dislocated workers. This proposal, incorporated in the Reemployment Act of 1994, makes several innovations in the confusing web of current labor programs. First and foremost, the Administration proposes a single program for all workers, regardless of the cause of their dislocation. Second, the new program would expand the opportunities available to dislocated workers to improve their skills and find new jobs. Individuals could participate in long-term meaningful training and receive income support for up to two years while they are enrolled in training. The Administration also wants to create a system of "one-stop" centers for providing services and improve the collection and dissemination of labor market information to make it easier for people to find new jobs.

The Council supports the Administration's efforts to improve government programs designed to help workers adjust to the new economic realities. The Council also has several concerns in light of the Administration's proposal.

The Reemployment Act aims to eventually terminate Trade Adjustment Assistance (TAA), a program dating back to 1962, aimed at assisting those workers who lose their jobs due to trade. While there are strong arguments in favor of maintaining a program tailored for trade-impacted workers, the major objection in rolling this program into a general program is that it would result in a net reduction of benefits provided for those workers.

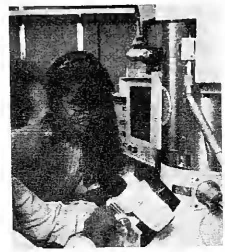
A core issue in the debate over dislocated worker programs is

whether these programs should provide guaranteed benefits (an entitlement) or have spending limits. Currently, TAA is an entitlement and general assistance for all dislocated workers (under the Economic Dislocated Worker Adjustment Assistance program) has a spending cap. The Administration has attempted to make some in-roads in this debate. On the one hand, the Administration is concerned that the quality of benefits may be compromised under strict spending limits. On the other hand, the Administration realizes that longer training and income maintenance for those in training are critical to promote serious adjustment. The Reemployment Act proposes income support for those undertaking training, but does not go far enough in ensuring adequate benefits for *all* workers in need. Furthermore, there is insufficient effort at designing a secure funding base to insure the long-term viability of the program.

Most people agree on the importance of training the nation's workforce, both while employed and between jobs. Yet during a time of limited public resources, there is heightened awareness of the costs of such programs. We need to better spend the resources we currently devote to training while at the same time expand these programs to encourage labor market flexibility.

> **"If our aim is to improve the living standards for all Americans, we must be concerned with the quality, as well as the quantity, of the jobs we create. In addition to creating high productivity, high income jobs, we must also make the proper investment to prepare our workers so that they can perform well in them."**

Critical Technologies



In its Second Report published last year, the Council recommended that the Administration adopt a new technology policy to improve US competitiveness. The main features of this policy, as developed by our Critical Technologies Subcouncil, chaired by Erich Bloch, a former Director the National Science Foundation, include:

- Moving $4-7 billion per year from defense R&D to civilian and dual-use R&D. [Figure 10]
- Significantly increase funding for industry-driven R&D programs (where industry shares in the cost and sets the direction of the R&D).

Figure 10
Civilian/Dual Use Industrial Technology Programs

	FY93	FY94	FY95	Percent Change FY94-FY95
	($ in millions)			
Advanced Technology Program (NIST)	68	200	451	128
Technology Reinvestment Project (ARPA)	472	554	625	13
Manufacturing Extension Program (NIST)	18	30	61	103
Technology Transfer (CRADAs, several agencies)	384	551	865	57

Percentage Distribution of Civilian and Defense R&D

	FY93	FY94	FY95
Dual Use Counted as Defense			
Civilian R&D	41	44	44
Defense R&D	59	56	56
Dual Use Counted as Civilian			
Civilian R&D	43	47	46
Defense R&D	57	53	53

Source: Budget of the United States, Fiscal Year 1995

- Focusing federal procurement and R&D projects in areas that would help drive commercial technologies, such as in defense procurement and initiatives to develop a national information infrastructure or intelligent vehicle/highway system.
- Improving the financing of the commercialization of technology.
- Improving the infrastructure for manufacturing and technology commercialization, including programs to help small manufacturers modernize.
- Restructuring the priority setting and management of federal R&D, and increasing private sector input to this process.

The Administration has begun to implement a new technology policy largely reflecting the Council's recommendations. These steps are promising, but many of the changes needed to develop an effective US technology policy are structural in nature and cannot be fixed in a single year. For our technology recommendations to accomplish their goals several things must happen over the next several years:

- Congress must appropriate funds for programmatic increases in the President's budget request in FY 1995.
- The work must continue, both in the Administration and the Congress, in the FY 1996 and FY 1997 budgets. This promises to become increasingly difficult under the caps in the budget agreement.
- The government and private sector must work together to ensure that the new and expanded programs work as intended, and that they are evaluated and modified as necessary.

Although the Administration has adopted an ambitious new approach to managing its R&D budget, the nation will not have a well-managed R&D program until comparable, and more difficult steps are taken to improve the management of science and technology in the Congress.

The R&D budget is highly fragmented in Congress, divided among

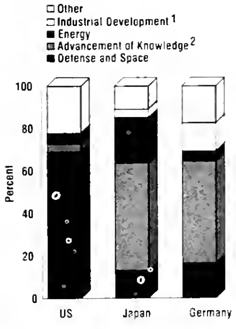
nine appropriations subcommittees. The authorizing committee that has the clearest focus on the R&D budget, the House Committee on Science, Space, and Technology, authorizes less than 30 percent of the R&D budget. This fragmentation makes it very difficult to set priorities, especially for multi-agency programs.

In its recommendations last year, the Council noted the need to establish a better process in Congress to make decisions on science and technology, such as realigning appropriations subcommittees to bring more key technology programs under a smaller number of subcommittees, or by establishing a process by which authorizing and appropriating committees together can examine the whole R&D budget. These recommendations are increasingly important.

The Council is encouraged by the recent passage of technology legislation by the House and Senate. The legislation includes many of the Council's recommendations. We hope that Congress will act promptly in addressing the differences in the two versions. The legislation would establish a program by which the federal government would make loans to technology development finance corporations, which would then invest in early stage financing for new technology ventures. Although there is support for the federal government helping to correct market failures in the financing of technology, the Subcouncil has two concerns with the specific proposals.

First, the Subcouncil believes that although there may be a need for increased early stage financing, the main problem is in later stage financing for capital intensive projects. A variety of federal, state, and private sources currently provide funding for early stage development, although more funds could be used. Funding is very limited.

Figure 11
Composition of Federally Funded R&D



1 The US spends 0.3 percent of its R&D on industrial development

2 Includes only research for the US. The US does not have general university funds

> "The Administration has begun to implement a new technology policy largely reflecting the Council's recommendations. These steps are promising, but many of the changes needed to develop an effective US technology policy are structural in nature and cannot be fixed in a single year."

however, for capital intensive projects. Venture capital funds can individually support ventures that require $3 to 4 million; several funds working cooperatively can support ventures of up to $30 million. Some technologies, however, require significantly greater amounts of funding to become successful, and it is in some of these technologies (such as flat panel displays or lithography for semiconductor manufacturing) where US industrial competitiveness is the weakest.

Second, venture capital firms, as currently structured, may have difficulty taking advantage of the loan provisions in the House version. Venture capital firms can not transfer liabilities acróss investment projects, since it would expose the partners to a liability greater than their investments. This makes it particularly difficult for venture capital firms to receive government loans. The Council continues to strongly support prompt final passage of this legislation and hopes that the Department of Commerce will seek private sector input as it refines this proposal, as called for in the current legislation.

The federal government's role in promoting research primarily through the tax code has been recently supplemented by serving as a more active participant in promoting American leadership in emerging technologies. This expanded role raises the question of what eligibility criteria should govern participation by US and foreign firms in federally-funded technology programs. Presently, different federal R&D programs have different, and sometimes ambiguous, criteria. In actuality, it would be difficult to develop a rigid set of requirements applicable in every situation. For example, some firms may perform their R&D at home even though they manufacture their products abroad. It may be counterproductive to deny such companies the opportunity to participate in federally-funded R&D.

The Council has asked the Critical Technologies Subcouncil to take a careful look at recent developments in this area. The Subcouncil is studying the various criteria currently being employed and will recommend guidelines for developing a coherent and flexible set of criteria aimed at maximizing the benefit of federally-funded technology programs to the US economy.

Public Infrastructure

The devastating impacts of the earthquake in Los Angeles provide another example of how dependent our economy is on the nation's infrastructure and how much we take that infrastructure for granted. No more glaring example of transportation's impact on the economy could be imagined than the collapse of the nation's busiest highway, the Santa Monica Freeway, and the attendant losses related to freight, commuting, and commerce. The astonishing rebuilding of the freeway in six weeks time is testament to its enormous role in the region's economy. Investment in infrastructure, which the Council has strongly recommended in its earlier reports, is crucial to support and enhance economic value, create jobs, and sustain the long-term competitiveness of the national economy.

The LA earthquake showed in the starkest of terms how infrastructure serves as an economic life-line linking communities, states, and the nation. In light of the central role infrastructure plays in productivity, economic growth, urban renewal, and job creation, and in light of the overlapping interests in infrastructure on the part of numerous government agencies, the creation of a White House committee or federal interagency task force on infrastructure is needed to coordinate a national strategy for infrastructure renewal and responses to high priority infrastructure needs.

Budget Proposals

The Council is encouraged by the positive attention given to investment in transportation infrastructure in the President's proposed FY 1995 budget. Recognizing the importance of public infrastructure in the national economy, the budget requests full funding of highway programs at the levels authorized in the Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA).[16] The proposed increase in Amtrak's capital improvement funds is also long overdue.

In its Second Report, the Council noted its concern with the "pork barrel" approach to infrastructure embodied in a series of Congressionally-mandated highway demonstration projects. These projects are singled out for special treatment by federal officials and lawmakers rather than competing at the state level for the limited resources available. We are pleased therefore to see the Administration's proposed rescission of funding for these highway demonstration projects.

Financing Proposal

Although the budget proposals for FY 1995 and beyond reflect a renewed attention to capital investment in infrastructure, the increases are barely large enough to make a dent in the decades-old deterioration of infrastructure. Chief among these problems is the practice by state and local officials of deferring maintenance on infrastructure to the indefinite future. The practice is so widespread that the category of "deferred maintenance" has taken on the connotation of an actual program item in state and local budgets. But deferred maintenance is not a program, it is a liability, and the public needs to be continually aware of the deferral of its responsibilities to maintain its own economic lifelines.

To tackle these problems head-on, Edward Regan, a member of the Competitiveness Policy Council recently proposed a large, fiscally sound, public infrastructure investment program.[17] The program includes the following components:

- A one-time major upgrading and renovation of the nation's deferred maintenance needs, on the order of $80 billion over a two-year period.
- Creation of taxable state and local infrastructure bonds to finance the program; such bonds would be able to attract investments from pension funds as well as other sources.
- Federal subsidies of the interest payments on these bonds over a 15-year period.
- Use of bond covenants that are enforceable in the courts and that require preventive maintenance of the infrastructure, thus locking in the benefits of the program.

There are several advantages of this proposal. First, it concentrates on preventive maintenance of existing infrastructure, a continuing priority for our nation. Second, it advocates paying for long-term infrastructure investment through appropriate long-term debt instruments, rather than through increases in operating funds. Third, this proposal would only minimally impact the federal deficit. It would require state and local governments to share

in the costs, and it would schedule the federal share over the useful life of the projects. The federal government would collect taxes on the interest payments on the taxable bonds, thus offsetting some of the costs of these interest payments. Finally, the program would create tens of thousands of jobs, a highly beneficial public purpose. The Council commends this proposal for serious consideration on the part of Congress and the Administration.

National Transportation System

Congress has the opportunity to establish a strategic basis for the nation's highways and transportation system as a whole and to link the transportation system to the goal of improving US competitiveness. The occasion for this is the submittal by the Department of Transportation in December 1993 of a proposed National Highway System (NHS) to Congress for review and adoption.[18] The proposed system of 158,000 miles of highways carries over 70 percent of the nation's commercial traffic, and connects to hundreds of ports, airports, terminals, and border crossings.

In announcing the NHS, the Secretary of Transportation placed it within the context of the development of a National Transportation System intended to fully integrate passenger travel and freight movement by air, rail, water, pipeline, and transit.

Congress has until September 30, 1995 to complete the adoption of the NHS. In the event that Congress does not act, the Department of Transportation will not be able to distribute FY 1996 funds in the NHS category and the NHS concept will disappear.

We urge Congress and the Department of Transportation to avoid this possibility, and go further in the direction of strengthening the NHS. This would mean extending to the NHS the high safety and quality standards of the Interstate system and enhancing the ability of the NHS — and the larger National Transportation System — to serve the nation's strategic competitiveness interests. One clear example of the strategic directions to be taken is the need — already identified by the Department of Transportation — to address infrastructure problems associated with the movement of international trade. Reaping the full benefits from the commercial opportunities resulting from the North American Free Trade Agreement, will require improvements in waterborne highway, aviation, and rail systems and their multiple connections in order to reduce border bottlenecks. More

"Investment in infrastructure, which the Council has strongly recommended in its earlier reports, is crucial to support and enhance economic value, create jobs, and sustain the long-term competitiveness of the national economy."

generally, the National Transportation System may become an appropriate framework for the reauthorization of federal transportation programs after ISTEA expires in 1997. Ultimately it could serve as a strategic basis for integrating not only transportation modes but also related communications systems.

Trade Policy

The Council notes that many of its specific recommendations on trade policy made in the Second Report have been implemented by the Administration.

In particular, the Council welcomes the conclusion of the Uruguay Round trade negotiations of the General Agreement on Tariffs and Trade (GATT). Taken as a whole, the new trade agreements and the institutional reforms in the GATT will provide a real economic stimulus to the United States and all countries which trade. The Administration, and in particular the Commerce Department, is doing a good job in coordinating export policy. Although there were delays in making several key appointments, the mechanisms being used — in particular the Trade Promotion Coordinating Committee — now seem to be working well.

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We commend the Administration's recent decision to remove the requirement for shipment-by-shipment advanced approval for virtually all civilian telecommunications and computers exports to China and the countries of the former Soviet Union. This action is in accordance with the Council's recommendation to remove unilateral export controls. We hope that the Administration will continue working to eliminate all remaining export disincentives and that the Administration and Congress will agree on reform and rationalization of the Export Administration Act soon.

We note that the Administration is seeking higher budget authority for many export-related programs and we applaud this shift in priority. Although the Administration does not envision the Export-Import Bank program reaching as high as the $20 billion level recommended by the Council, the Administration estimates that it will increase from $16.7 to $17.5 billion in FY 1995.[19] The Council's recommendation for a unified budget function has not yet been followed, but the Office of Management and Budget (OMB) has put together a table of Export-Related Expenditures (Table 3B-13 in the FY 1995 Budget). We are encouraged by the prospect that a unified budget function may be employed in FY 1996.

With regard to international trade, the Council recommends the following: First, we urge the Administration to submit the GATT implementing legislation as soon as possible now that the GATT Agreement has been signed.

Second, we urge the Congress to renew the President's trade negotiating authority (which expired on December 15) for new multilateral, regional and bilateral agreements. The President should not be handicapped in foreign economic policy in a rapidly changing world.

Third, we again reiterate the importance of assuring a competitive exchange rate for the dollar. Maintenance of the recent appreciation of the yen is an essential element in reducing Japan's huge and disruptive global surplus.

Improving the Policy Process

In our earlier reports, the Council called for more effective approaches at the federal level to design and implement a national competitiveness strategy. We note that some progress has been made in the past year, but we believe that further steps are needed. This section will discuss four relevant areas in the federal budget process: (1) investment budgeting; (2) budget caps; (3) competitiveness impact statements; and (4) industry baselines.

Investment Budgeting

The federal budget process lacks any systematic way to assess the appropriate trade-off between current consumption and investment. The President's budget is put together with recommendations

from each department. The Congressional budget committees review the budget according to CBO function categories and aggregate outlays and deficit. The House and Senate appropriations committees divide the budget up by subcommittees, usually along agency lines. Even though the budget is assembled in three different ways, none of these ways directly analyzes compositional issues such as investment versus consumption.

In prior reports, the Council has recommended that the US government establish an investment budget to highlight the share of federal spending going to public investment and to permit careful consideration of whether that share is adequate. By an investment budget, the Council is not referring to a capital budget that separates physical capital and credit flows from the rest of the budget. An investment budget is a far simpler reform to accomplish.

Defining Investment

There is no simple definition of public investment. Generally, these are government programs to purchase goods and services which provide significant positive externalities over a long period of time.[19] Investments typically have lengthy payoffs and produce tangible results. They lengthen the productive life or increase the productivity of labor and/or capital.

The General Accounting Office (GAO) has suggested that any investment budget should probably exclude most defense expenditures (but include defense R&D), most federal civilian buildings, and major equipment for carrying out federal functions. OMB has taken a broader view in its analysis of investment. There will never be complete agreement about the definition of public investment. Since our proposal does not relax budget disciplines (as a capital budget might), there is no need for full agreement as long as the investment budget is clear about what it includes and is consistent over time.

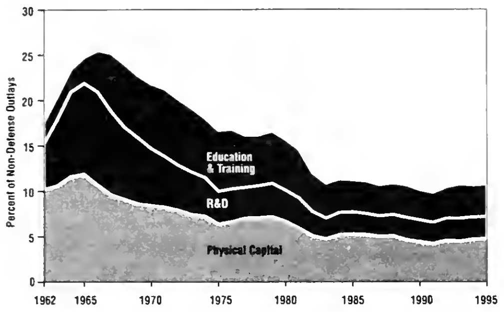
The value of an investment budget lies not only in knowing the percent of spending that goes for investment, but also in looking at trends and using the data to establish investment targets. There would also be great benefit in estimating how much investment is needed in future years so that the US government will be able to consider in advance whether sufficient funding will be available.

The Council strongly supports the Clinton Administration in its efforts to increase federal investment but we urge further action. By making the consideration of investment an explicit part of the budget process, the Administration can develop a more coherent investment plan. By monitoring public investment more transparently, the Administration and Congress may have an easier time persuading the public that such investments must be preserved and, if possible, increased.

For many years the President's budget has included a breakout of investment expenditures, including physical and non-physical investment, and both defense and non-defense investment. But there is no evidence that this presentation influences decisionmaking. It appears that it is put together by the OMB after all of the individual budget decisions are made. No Congressional committee uses it for policy making. There is little public attention to these numbers.

Based on OMB's categorization, of investment programs, the Council has examined federal investment levels over the past thirty years. [Figure 12] We note that the Clinton Administration's FY 1995 budget does call for an increase in non-defense investment over last year's level. But taking a thirty-year perspective, we find that the share of non-defense outlays going to investment has steadily declined.[20] The current level of investment is down substantially from a generation ago. Federal investment (including physical capital, research, education and training) is lower

Figure 12
Composition of Federal Non-Defense Investment



Source: Office of Management and Budget

both as a share of non-defense budget outlays and as a share of GDP.[21] In 1965, federal investment constituted approximately 25 percent of non-defense outlays and 2.5 percent of GDP. In 1995, federal investment is projected to be approximately 11 percent of non-defense outlays and 1.9 percent of GDP. The Council believes that we need to increase public investment in these areas, as well as make better use of the dollars we are currently spending.

The Council has also worked with GAO to analyze the FY 1995 budget based on GAO's definition of investment which looks at federal programs that lead to long-run productivity improvements in the private sector. This is narrower than the above measure in some ways (excluding federal structures for the operation of government) and broader in others. Based on the GAO definition, we find that the Clinton budget does not succeed in increasing investment above the 1993 level. In 1993, such investment was 1.7 percent of GDP, slightly higher than the level is expected to be in FY 1995.

The Council's Proposal

The federal government needs to do a better job of tracking public investment which is so important to raising long-run productivity. The budget process we envision would start with a "soft target" from the National Economic Council for the percent of the total budget that should go for public investment. After the President makes his budget decisions, OMB would prepare an investment budget for the Congress. Specifically, investment would be subdivided by budget function and class, and then totalled.[22] The total should be shown as a percent of total civilian federal spending and as a percent of GDP.

The Congress might ask CBO to develop comparable investment figures for other countries. Ideally, the budget resolution would include an explicit statement on the appropriate level of federal investment. There might also be Congressional hearings on the adequacy of the investment share and level, as compared to other countries. In addition to budget-year numbers, the OMB tables should include projections of what the Administration intends to invest over a five-year period. The budget resolution should specifically consider the adequacy of the five-year numbers and the likelihood that such investments will fit within discretionary spending ceilings. Overall, the Council suggests a soft non-defense investment target of 12 percent of total

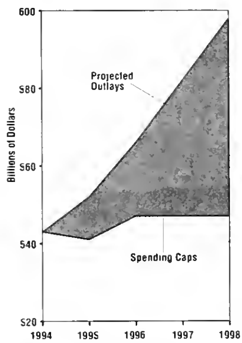
non-defense outlays (or 2.1 percent of GDP in 1993). This would require an additional $16 billion shift into public investment in the FY 1995 budget, from $134 billion to $150 billion.

Budget Caps on Discretionary Spending

In its Second Report, the Council endorsed strong efforts to reduce the deficit on the scale proposed and later largely achieved by the Administration. We pointed out that such deficit reduction was the linchpin to a competitiveness strategy. The Council is pleased that the economy is currently stronger than many of us might have predicted a year ago. This good economic news, although tempered by remaining unemployment and falling real wages, provides all the more reason for the Administration and Congress to stay the course on deficit reduction. As we noted in our First Report, the eventual goal should be to move the budget into surplus. The current recovery is a good time to accommodate structural reforms and to think about the long term.

The discretionary spending caps enacted in 1990 and re-extended in 1993 have been a helpful management tool to Congress, but may now have outlived their usefulness. If continued beyond FY 1995, these caps will require very large cuts from the budget baseline. [Figure 13] We are doubtful that the necessary increases in public investment can be made under the constraint of these budget caps.

Figure 13
Projected Discretionary Spending



ngressional Budget Office

Reducing the deficit does not require a freeze in discretionary spending. There is no reason why the United States should put itself in a straightjacket on many categories of government spending, including defense. Thus, while the Council strongly reaffirms the need to continue lowering the federal deficit, we believe that consideration should be given to amending the Budget Enforcement Act to permit entitlement cuts or revenue increases to be used to pay for increases in federal investment as recommended above. The budget process should be focusing on the amount of deficit-spending, not on whether such spending is discretionary or mandatory. It might be noted that the Congress has tried caps on the deficit (Gramm-Rudman) which did not work and it is now using caps on discretionary spending which do work but have negative side effects. An intermediate solution — not yet tried — would be to allow derogations from the discretionary cap if done in a deficit neutral manner. More attention should be given to making cuts in entitlements and tax expenditures for affluent Americans.

Competitiveness Impact Statements

Under the Omnibus Trade and Competitiveness Act of 1988 (2 U.S.C. 194b), the President and heads of agencies are required to prepare a "Competitiveness Impact Statement" (CIS) on all legislative proposals which may affect the ability of American firms to compete in international commerce. The statement is supposed to be submitted to the Congress along with the legislative proposal.

Unfortunately, neither the Reagan, Bush, nor Clinton Administration has complied with this law. In both its First and Second Reports, the Council pointed out the Executive Branch's continuing responsibilities under this law. As far as we are aware, no specific CIS reports have been filed by the Clinton Administration.

The Council endorses the concept of a competitiveness impact statement. We have found that all too often the federal government enacts legislation or adopts new policies that impair US competitiveness (e.g. export controls for foreign policy reasons). In some cases, the loss of competitiveness may be a trade-off for some other social good. But in many cases, the impact on competitiveness is an unintended side effect. We believe that by incorporating the potential competitiveness effects into the lawmaking and regulatory process, policymakers might be sensitized to the impact of their decisions on our standard of living.

Given the political difficulties of effecting any major policy reform (e.g. health care), the President should arm himself with the best possible arguments. For many proposals, the competitiveness linkage is key and may help the Administration achieve reform.

The Council recognizes that what looks to us like useful analysis may look to busy policy officials as unnecessary paperwork. We see no reason to do a CIS on every proposal. But for those 10 or 20 initiatives each year that may have a significant effect on competitiveness, we believe that such an analysis is warranted.

When the Congress legislated this requirement in 1988, a six-year sunset was established. Thus, the CIS law will expire in August 1994 without ever being tested. This analytical experiment has proved disappointing.

The Council recommends that the Congress enact a new CIS requirement, but with two changes from the current law. First, the responsibility should be assigned elsewhere than the agency originating the proposal — such as an independent agency like the US International Trade Commission (ITC), or perhaps the Congressional Budget Office.[23] Second, the CIS requirement should be narrowed to just those new proposals by the Administration with a significant impact on competitiveness. Some preliminary analysis would be needed to determine when a proposal's effects cross a threshold of significance.

"The federal government needs to do a better job of tracking public investment which is so important to raising long-run productivity."

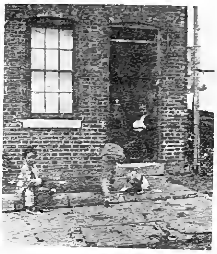
Industry Baselines

In its First Report, the Council urged that the President designate a lead agency on competitiveness issues and assign it the task of raising the nation's awareness of the problem. The Clinton Administration has designed a new policy coordination structure including the National Economic Council and the National Science and Technology Council. While these institutions are far more proactive than previous institutions, we think more can be done to focus on competitiveness both in decisionmaking and in educating the public about the need for economic change.

One of the Council's specific recommendations was that a federal agency begin assessing the likely course of key American industries. This would provide a baseline against which to judge specific competitiveness problems in the future.

Last year, the Council reported that the ITC was planning to create an Office of Competitiveness to undertake such analyses. The ITC has since decided to postpone creating the office, but has begun performing baseline studies of a limited number of industries. The Department of Commerce is just beginning an effort of developing industry benchmarks. It is still too early to know how extensive this effort will be. The Council urges the President and Congress to give renewed consideration to the importance of industry baselines and who should prepare them. Given their existing capabilities, we continue to believe that the Congress should provide a mandate and adequate funding to the ITC or the Department of Commerce for this purpose. The ITC might be given the task of performing both these baseline studies and the competitiveness impact statements.

Social Issues



Last year, the Council identified social issues as a competitiveness concern and began to lay out an agenda for further consideration.[24] At the request of the Council, James Renier, former CEO of Honeywell, prepared a preliminary paper directing the Council's attention toward the critical issues of children's readiness to learn and preparedness for school, as well as the social mandates borne by schools.

What is the relationship between social issues and competitiveness? A competitive economy must be defined more broadly than by its balance of trade. Competitiveness requires a rising and sustainable standard of living, primarily but not exclusively defined in economic terms. Moreover, this

standard of living or quality of life must extend to all Americans, not merely the privileged few or the broad middle class.

No one who picks up a newspaper or turns on a television in modern day America can fail to notice that a substantial segment of society is not sharing in the current recovery from the recession. The poor are falling increasingly behind. Indeed, poverty and its insidious effects go beyond the boundaries of disadvantaged communities to weaken the fabric of society in ways we are only beginning to understand. Certainly the competitive potential of the economy as a whole is diminished by our inability to tap the full potential of all members of society.

The social issues confronting the nation — crime and violence, poverty, unemployment, substance abuse, inadequate education, infant mortality, family breakdown, homelessness, etc. — are intensified in the inner cores of the nation's largest cities, once the source of significant industrial activity. Here the legacy of racial discrimination has combined with disappearing economic opportunities in a devastating cycle of poverty and violence. But similar problems are found in other parts of the country, including a great many rural areas that have been left behind in the race for economic progress.

Most disturbing — and perhaps serving as a much-needed wakeup call — is the realization that has slowly dawned on the nation over the last five years: the neglect of social issues is scarring the next generation of Americans. As a society we are throwing away the future productive capacities of a growing portion of our people.

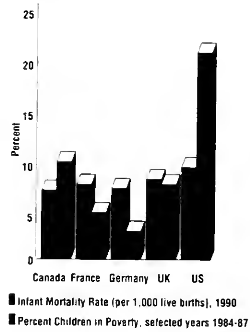
More children are living in poverty in the 1990s than in the last twenty years. [Figure 14] Twenty percent of all American children are living in poverty; among minorities, the rates are even higher: 38 percent of Hispanic children, and 44 percent of African-American children.[25]

Figure 14
Poverty Rates for Young and Old

Source: Department of Commerce

The Carnegie Foundation for the Advancement of Teaching has found that one third of children entering kindergarten are not equipped mentally or physically to start the learning process.[26] More recently, the Carnegie Task Force on Meeting the Needs of Young Children issued a warning that the youngest children of America — those under age three — are living in a "quiet crisis." The Task Force noted that "a staggering number are affected by one or more risk factors that undermine healthy development."[27] The gap between children from different social backgrounds is substantial at a young

Figure 15
International Comparison of Child Well-Being



Source: Kids Count Data Book 1993

age, and grows steadily larger as children get older.

Moreover, research is showing that the effects of poverty, poor learning and academic performance, and unstable family life are long-lasting, affecting an individual's prospects for job and marital stability well into adulthood.[28] Those, for example, who drop out of high school are plagued by the consequences of this act over their entire careers. White and black males age 25 to 34 who do not finish high school earn on average 27 percent less than those who do finish. For white and black females, the disadvantage is even larger — 39 to 42 per cent less than high school graduates.[29]

On a variety of indicators, American families and children are faring poorly compared to other industrialized nations. [Figure 15] Some researchers attribute more than half the increase in child poverty over the last decade in the United States to changes in US family structure.[30] One in four children today lives in a single-parent family, a 9 percent increase just since 1985.[31] Children in one-parent families are up to ten times more likely to experience poverty in childhood for seven years or more compared to children in two-parent families, and two or three times as likely to have emotional and behavioral problems.[32]

Children grow up to be the nation's workers. The link between the social problems affecting our youth today and our future competitiveness is easy enough to draw. Social problems weaken American competitiveness, both now and in the future, in both obvious and subtle ways.

Reducing the size of the workforce. Intractable social problems rob the nation of the productive capacities of a sizable percentage of the population. This may include criminals, addicts, the homeless, single parents, and others, who have dropped out of, or never joined, the labor force. These people represent resources lost to the economy. Those without a high school diploma are being steadily edged out of the workforce. Although the high school dropout rate has improved slightly in the last two decades, labor force participation rates among 25 to 34 year old males with less than 12 years of school dropped 9 percentage points between 1971 and 1991.[33]

Young people in disadvantaged communities do not want to be permanently sidelined from the workforce, but they are particularly sensitive to the state of the local labor market. A study of out-of-school young men in a number of urban areas in the 1980s concluded that local labor market shortages greatly improved the employment opportunities of disadvantaged young men, particularly black

"The neglect of social issues is scarring the next generation of Americans. As a society we are throwing away the future productive capacities of a growing portion of our people."

youths, substantially reducing their unemployment rate and increasing their hourly earnings.[34]

Conversely, a lack of work during crucial periods in a person's career development can lead to permanent disadvantage, as youths lose ground to peers who are better trained and better integrated into the workforce. A steady prevalence of unemployment can lead some to give up on finding work and permanently exclude them from in the labor force. Persistent pockets of severe unemployment, reaching levels of 37 to 40 percent among black male and female 16 to 19 year olds,[35] can discourage job-seeking and deny youths the entry-level experience and skill development needed to build successful work paths. Some 5 percent of youths age 16-19 (9 percent of black youths, 8 percent of Hispanics) report no productive role in society: they are not in school, in the labor force, or in the military, and they do not describe themselves as homemakers.[36]

Reducing the skill level of the workforce. Poverty and other problems interfere with the ability to learn, producing workers who are poorly equipped for the workplace. Numerous studies have found a strong correlation between measures of academic achievement in mathematics, reading, science, and problem solving, and subsequent productivity on the job.[37] Yet at age 17, fewer than half of American students have the skills and basic knowledge required for college or many entry-level jobs.[38] Government and business bear the costs of remedial education and training, the need for which continues to escalate. Other social problems also affect performance on the job — ranging from substance abuse to poor health status to a lack of support for family emergencies.

High cost of crime. Violent crime has risen steadily in the last decade, and the costs to society has been escalating as well. A recent tally of the costs associated with crime — including the costs of the criminal justice system, public police and security systems, private security systems, damage to urban economies, medical care, property losses, and lost work years and reduced productivity associated with crime — amounted to a total annual drain on the US economy of over $400 hundred billion.[39] And yet even this staggering sum cannot make the victims of crime whole, as anyone who has experienced the ravages of crime will attest.

Drain on government expenditures. In addition to public security and criminal justice expenditures, a growing portion of federal, state, and local government budgets is devoted to ameliorating social problems, including public assistance, health care, and social services. With this type of spending we are running as fast as we can just to stay in place. In a time of limited public resources, this spending hampers our ability to invest in people and the economy, which would improve productivity and contribute to a broad-based rise in living standards. Preventing problems from occurring rather than spending money in a futile attempt to fix them is a cheaper and ultimately more effective solution.

The Clinton Administration Agenda

The Clinton Administration has identified social problems as a priority for its domestic agenda. We commend the Administration and Congress for taking the first steps in this direction; the expansion in the earned income tax credit is particularly noteworthy. The (EITC) will help reward people for working, at least to the extent of keeping working families out of poverty. Another promising effort is the Administration's community development initiative, combining tax benefits, social service grants, and improved program coordination in nine "empowerment zones" and 95 "enterprise communities." Even more significant will be action in the areas of crime and welfare reform, two stated priorities of the Administration this year.

Some analysts point to the experience of certain European countries and argue that building a too-generous safety net detracts from the beneficiaries' incentives to take jobs and society's ability to create jobs. Others point to the constructive elements of these programs in upgrading workers' skills and sharing the benefits of economic growth. One of the useful elements of the current debate on welfare reform is the attention being paid to the unintended consequences and incentives created by the welfare system on its recipients' levels of dependency, work and lifestyle choices.

Nevertheless, there are numerous areas where government expenditures, as well as the active involvement of the private sector, can make a difference. Studies are showing that increased expenditures on policing, particularly community policing, could make a major dent in violent crime. Expenditures on rehabilitation may be the only way to effectively turn around drug abuse. Preventive spending in health care, community development, and youth and family services is still sorely underutilized. Early intervention programs such as Head Start can be highly cost-effective, but only when they are done well. Programs that seem to work tend to be those that feature adequately funded and trained staff, that intervene deeply, and that last a long time.

Social problems can rarely be solved in isolation. We have too many fragmented programs and benefits, aimed at correcting one particular problem, such as drug abuse, in isolation from other interventions. The notion of "one-stop shopping" now being put forward in training and other programs should be applied more broadly as well. Whenever feasible, a common aim for many of our social problems should be to get people back into the labor force as productive participants in the economy. Emphasizing society's interest in a productive workforce — and a competitive nation — is neither heartless nor imprudent. In the long run, it will serve individuals, their communities, and the nation well.

In some cases — such as the nation's elementary schools — we are heading toward more integration of services, but without adequate funding of the mandates. Schools are now called on to provide social services ranging from "health programs, day care, drug education, parental education, counseling for teenage parents and dropouts, AIDS instruction, suicide prevention and services for children from birth through age three."[40] Yet our schools are not given the resources to deal with these mandates, while their primary mission

"A strong economy and a healthy society support each other. The strength of one builds the strength of the other. And competitive power depends on both."

—James Renier

of education is crowded out by other demands.

The current debate over social problems has developed into the usual stand-off between liberals calling for more money to be spent and conservatives calling for cultural changes that will restore traditional values to disadvantaged communities. The Council sees both sides as offering an important piece of the whole: more money must be invested *and* more responsibility must be nurtured and shared across our communities. Past experience with educational programs and welfare reform should provide us with at least a few lessons learned well. Whatever the approach taken and however much money is authorized in Washington, a lack of actual funding and indifferent implementation at every level can render any initiative dead on arrival. Effective implementation of programs is the only way to restore the belief that our social problems can be tackled successfully.

James Renier has pointed out, "A strong economy and a healthy society support each other. The trength of one builds the strength of the other. And competitive power depends on both."[41] America cannot realize its full economic potential if we abandon our disadvantaged populations. Finding the will and the means to weave the social fabric into a tighter, more inclusive bond is one of the most important tasks we can undertake. The Council sees its own contribution in this area over the next year as focusing on issues related to child readiness to learn, the effectiveness of pre-school and supplementary school programs, and youth dropout, unemployment, and labor force participation rates.

Capital Allocation

In its Second Report, the Council noted that the United States has the lowest investment rate among major industrial countries, half that of most and one third that of Japan. Most of the increase in national investment necessary to meet the Council's goal of raising living standards will have to come from the private sector.

Last year the Council reported that "there is a need to develop a whole new approach to defining the value of a corporation and to measuring long-term corporate performance." As part of this effort, the Council asked Robert Denham, Chairman of Salomon, Inc., and Professor Michael Porter, of the Harvard Business School, to co-chair a Subcouncil on Capital Allocation.

Over the past few years, a series reports have been written providing a rich analysis of the strengths and weaknesses of our financial system. Their most prominent common theme is that the economy could significantly benefit from the development of more patient relationships between investors and the companies in their portfolios. In particular, the climate for long term capital investment may be enhanced when stockholders hold significant stakes for longer periods and play a more active role in monitoring company performance.

Such "relationship investing" increases the incentive for investors to acquire a better understanding of the company's strategic direction and the effectiveness of its board of directors. It also increases the incentive for management to be accountable to owners in order to maintain their confidence in the company's strategic vision. Better investor understanding of long-term company strategy and enhanced management accountability to financial markets hold the promise of improving both the magnitude and efficiency of domestic private investment.

There has been significant evidence of progress in this direction during the past two years. In October 1992, the Securities and Exchange Commission adopted new regulations which considerably reduced restrictions on communication among shareholders. This limited deregulation has improved the effectiveness of shareholder efforts to monitor boards of directors and the performance of companies. During 1992 and 1993, boards of directors of a number of large, poorly performing companies removed their chief executives. These high profile dismissals appear to have stimulated the boards of many other companies to play a more active and independent role in overseeing management.

While these are positive developments, the test of long-term relationship investing is not simply its capacity to respond to a crisis of failing managers and boards. More important is its capacity to preempt such crises through an ongoing process of oversight. This process must foster not only a culture of accountability, but also a climate in which managers routinely make the long-term investments necessary for their companies to compete effectively in world markets.

Research suggests that US companies have not been adequately investing for the long-term. Net private investment as a share of GDP has declined considerably since the 1960s and 1970s and is well below the level of many of our industrialized country competitors. And while these aggregate statistics reflect primarily the macroeconomic climate — including private saving rates, fiscal deficits, inflation and interest rates — studies have also produced worrisome evidence concerning the composition of private investment:

- R&D spending as a share of GDP declined considerably from 1986 to 1992.
- The hurdle rates American firms use to assess investment projects are higher in relation to the cost of capital than anticipated by financial theory.
- Surveys of American and foreign CEOs reveal that both perceive the investment time horizons in US companies to be shorter than those of their major competitors.
- American companies appear to invest at lower rates than their foreign counterparts in intangible assets such as workforce training, new market development and supplier relationships.

The Capital Allocation Subcouncil is developing policy recommendations to improve the contribution of private investment to the nation's rate of productivity growth and the creation of good jobs. The Subcouncil is building on previous research by seeking to identify

whether there are specific changes in federal laws or regulations which might remove impediments to, or otherwise promote, long-term relationship investing. The Subcouncil includes representatives of the financial and corporate communities, relevant federal agencies, labor and the public interest, including a range of recognized non-governmental experts in securities law, taxation, accounting and economics [see list of members on page 49].

The Subcouncil is focusing on the following seven areas:

- Creating incentives for long-term equity holdings and significantly reducing the debt bias of the tax code;
- Encouraging closer monitoring of boards of directors and management by shareholders;
- Encouraging larger holdings in individual companies by shareholders;
- Improving information available for assessing long-term shareholder value;
- Encouraging long-term employee and management ownership;
- Reducing unnecessary costs of shareholder litigation which inhibit corporate disclosure; and
- Improving small business access to debt and equity finance.

"American companies appear to invest at lower rates than their foreign counterparts in intangible assets such as workforce training, new market development and supplier relationships."

Conclusion

As the Council noted in its First Report, the nation's economic policies suffer from "short-termism." We allow economic and social problems to fester until they become unbearable, and then we are unwilling to make the necessary sacrifices to solve them. Too often the federal government begins the process of reform (welfare reform, energy policy, national health insurance are but a few examples), but then refrains from making real change. The Clinton Administration is to be commended for its willingness to address some of the nation's problems in all of their complexity.

The economic recovery of 1993 has already led some observers to say that America has solved its competitiveness problem. The Council respectfully disagrees; there is

little evidence to suggest that the current economic pickup will lead to substantial long-run improvement in our standard of living. Nevertheless, the current recovery does provide an opportunity to seriously evaluate our priorities, increase national saving, and invest more in plant and equipment, R&D, infrastructure, education and training. This may require changes in federal budget rules.

The changes that we are recommending will take many years to implement. As the European Commission noted in its recent White Paper, "the most serious challenge facing policy makers will be to maintain the awareness of the need to implement appropriate macroeconomic and structural policies even when the recession is over."[42] This, too, is the challenge facing our policymakers in America. The Council hopes that in offering these views to the President, the Congress and the American people, it will raise awareness of the challenges confronting the nation and ways to address them.

Notes

1. Robert J. Gordon, "Wishful Thinking," *Forecast*, January/February 1994. Professor Gordon estimates that the cyclically adjusted productivity growth for 1993 was approximately 1.3 percent.

2. In its Second Report, the Council noted that "increases in private saving are highly desirable but difficult to achieve." The Council continues to believe that we are not doing enough to encourage individuals to save more. A national campaign, led by the President, could contribute to achieving this goal.

3. *Building A Competitive America*, Competitiveness Policy Council, March 1992, p. 25.

4. The reform proposals differ on several points. One is whether there should be a mandate for insurance for everyone or whether the government should try to reduce barriers to obtaining coverage. Another is whether employers should be required to make insurance available and, if so, what percentage they should pay. A third consideration is how much assistance should be given to small employers or lower income individuals. A fourth is the extent to which health utilization should be governed by standards or left to the discretion of patients and doctors.

5. This section draws primarily from two pieces of research commissioned by the Council: Henry Aaron and Barry Bosworth, "Health Care Financing and International Competitiveness," February 10, 1994, and Lewin-VHI, Inc., "The Impact of the Health Security Act on Firms Competing in International Markets," January 12, 1994.

6. There are numerous problems using life expectancy as a proxy for health. First, life expectancy covers all causes of death. This is particularly important in the case of the United States, since it has the highest death rate due to crime among all the industrialized countries. Every health indicator has its own limitation, which hampers this type of analysis. The broader point still remains that the United States spends significantly more on health care than the other industrialized countries and Americans do not appear to be proportinally healthier.

7. If health care reform does not result in higher individual saving, higher business investments, and lower federal deficits, and the "reform dividend" is redeployed to other types of consumption, the reform will not have any significant impact on the nation's competitiveness.

8. Aaron and Bosworth suggest that at least 80 percent of the increase in health care costs is shifted back to workers. The Council realizes that this may not always be the case. If health costs are not predicted well, employers may have to temporarily absorb some of the costs themselves. In industries that are strongly unionized, additional health care costs may result in lower profits or higher prices. Still, the most likely result of rising health insurance costs is lower wages.

9. If one views the employer as the payer, there will be a first round reduction in competitiveness, but as the dollar falls, exports would rebound.

10. See Aaron and Bosworth, Table 7. Based on full-time equivalents.

11. Lewin-VHI Inc., Table 7.

12. Eighty-two percent of all large companies are self-insured.

13. A corollary to this point is that if health care spending is controlled, workers may expect those savings to be translated into higher wages.

14. Of course, to the extent that health care costs are not fully absorbed by employees, they will be passed to stockholders and consumers, through lost sales, higher prices or lower profit margins.

15. Annualized data for production and nonsupervisory workers in private nonagricultural industries. These BLS data may in fact over-estimate the decline in real wages. First, the real wage series does not include all workers. Second, experts such as Barry Bosworth have suggested that the deflator used overstates the decline. Third, Frank Levy has argued that real wage data track different people over time and therefore average family income data are preferred. Although average family incomes have been rising, it should be noted that more families are now dependent on two wage earners.

16. In the President's budget request for FY 1995, core formula programs of ISTEA will be fully funded with a highway obligation ceiling of $20 billion and transit formula grants at $2.9 billion.

17. Edward V. Regan, "Investment, Jobs, and Economic Growth," The Jerome Levy Economics Institute, October 1993.

18. Like its predecessor, the Interstate Highway System built in the 1950s and 1960s, the purpose of the National Highway System as envisioned in ISTEA is to help meet national defense requirements and serve interstate and interregional travel.

19. Thus, income maintenance to a needy person, however worthy, is not an investment, as it does not increase the capital stock per person.

20. These figures include three categories of public investment — education and training, research and development, and public infrastructure. OMB reports several additional categories (e.g. commodities), which are excluded from this analysis. Using the broader measure yields a similar conclusion. We also examined investment as a percent of non-defense outlays excluding interest payments, and found a similar result.

21. When state government spending on education, training and highways is added, the decline is less dramatic, from approximately 10 percent of GDP in 1975 to approximately 8.5 percent of GDP in 1991.

22. The functions might include: education and training, transportation, environment and health. The classes might include: equipment, structures, payments to individuals and grants to states.

23. The current law is already mandatory, so it cannot be even more so. One alternative would be to maintain the responsibility with the Executive Branch but to remove the provision barring judicial enforcement of the CIS requirement. But the Council does not want to promote such litigation.

24. At the time of this report, the Council had just begun its work on this topic. The following section was drafted by the Council's staff, and will serve as a basis for further work by the Council.

25. *Kids Count Data Book*, Center for the Study of Social Policy, Washington, D.C. 1993.

26. *Just the Facts, A Summary of Recent Information on America's Children and Their Families*, National Commission on Children, Washington, D.C. 1993.

27. *Starting Points: Meeting the Needs of Our Youngest Children*, Carnegie Corporation of New York, April 1994, p. xiii.

28. Barbara Dafoe Whitehead, "Dan Quayle was Right," *The Atlantic*, April 1993.

29. US Department of Education, National Center for Education Statistics. *The Condition of Education 1992*, Washington D.C. 1992.

30. *Just the Facts*, p. 7.

31. *Kids Count Data Book*, p. 14.

32. Whitehead, p. 47.

33. *The Condition of Education 1992*, Table 30-1.

34. Richard B. Freeman, "Employment and Earnings of Disadvantaged Young Men in a Labor Shortage Economy," in *The Urban Underclass*, Christopher Jencks and Paul E. Peterson, eds. Brookings, Washington, D.C. 1991.

35. Bureau of Labor Statistics Civilian Unemployment Rate, Table B-41.

36. *Kids Count Data Book*.

37. John H. Bishop, "Why the Apathy in American High Schools?" *Educational Researcher*, Jan-Feb 1989.

38. *Just the Facts*, p. 85.

39. "The Economics of Crime," *Business Week*, December 13, 1993.

40. James Renier, "Education and Competitive Strength," paper prepared for the Competitiveness Policy Council, 1993.

41. James Renier, 1993.

42. European Community, "Growth, Competitiveness and Employment," White Paper, 1993.

Capital Allocation Subcouncil

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About Our Members

RAND V. ARASKOG has been Chairman, President and Chief Executive Officer of the ITT Corporation since 1980. Mr. Araskog is a director of several corporations, the New York Stock Exchange, Dayton Hudson Corporation, Shell Oil, Dow Jones, and Alcatel Alsthom. He is a member of the Busines Council, the Business Roundtable and author of *The ITT Wars*. He spent five years at the Department of Defense during the late 1950s.

JOHN J. BARRY is International President of the International Brotherhood of Electrical Workers, a position he has held since 1986. He started as an apprentice in the electrical construction industry and has held numerous elected positions in organized labor since 1962. He is a Vice President and Executive Council Member of the AFL-CIO. He serves on many boards including the US Council for Energy Awareness and the American Productivity Center.

C. FRED BERGSTEN, Chairman of the Council, is Director of the Institute for International Economics, which he founded in 1981. He is also chairman of the Eminent Persons Groups created by the Asia Pacific Economic Cooperation Forum (APEC) in 1993 to advise its member governments on trade and investment liberalization in the region. He was Assistant Secretary of the Treasury for International Affairs from 1977-1981 and served on the senior staff of the National Security Council from 1969-1971. Dr. Bergsten is the author of 22 books on a wide range of international economic issues, most recently *Reconcilable Differences? United States-Japan Economic Conflict*.

WILLIAM GRAVES is Secretary of State of Kansas. He was first elected in 1986 and is now serving his second term. He is a member of the board of the National Association of Secretaries of State and of Leadership Kansas. He is also a member of the American Council of Young Political Leaders and has served as an election observer in Taiwan. Mr. Graves is active in numerous civic organizations including the Kansas Chamber of Commerce and Industry.

JOHN J. MURPHY has been Chairman, President and Chief Executive Officer of Dresser Industries, Inc. since 1983. He has been associated with Dresser since 1952 and has held numerous management positions at the company during that period. Mr. Murphy serves on the boards of a number of outside organizations, including the U.S.-Russia Business Council, PepsiCo, Inc., NationsBank Corporation, Kerr-McGee Corporation, Southern Methodist University, and St. Bonaventure University. He is also a member of the Business Council.

EDWARD V. REGAN is President of The Jerome Levy Economics Institute of Bard College, a non-partisan research organization which develops public policy alternatives. Before joining the Levy Institute in 1993, Mr. Regan served 14 years as New York State Comptroller. He was a former member of the President's Commission on Industrial Competitiveness (1983-1985). Mr. Regan is a frequent lecturer and author on the economy, government, institutional investments and financial markets.

BRUCE R. SCOTT is the Paul W. Cherington Professor of Business Administration at the Harvard Business School, where he has taught since 1962. Mr. Scott teaches a course in comparative economic strategies of countries and has co-authored a study of industrial policy in France, an analysis of the Venezuelan economy, and more recently a study of the prospects for

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LAURA D'ANDREA TYSON is Chair of the President's Council of Economic Advisers and a Member of the President's Cabinet. She is currently on leave from the University of California at Berkeley, where she was Professor of Economics and Business Administration, Director of the Institute of International Studies, and Research Director of the Berkeley Roundtable on International Economy (BRIE). She was a member of the Cuomo Commission on Trade and Competitiveness. Dr. Tyson is the author of several books and articles on US trade and competitiveness issues, including most recently, *Who's Bashing Whom? Trade Conflict in High Technology Industries*.

EDWARD O. VETTER is President of Edward O. Vetter & Associates. He previously held a number of positions at Texas Instruments including Executive Vice President and Chief Financial Officer. Since retiring from Texas Instruments, Mr. Vetter has served as Undersecretary of Commerce from 1976-1977, Energy Adviser to the Governor of Texas from 1979-1983, and Chairman of the Texas Department of Commerce from 1987-1991. He is a retired director of several New York Stock Exchange corporations, advisor to several venture funds, and a trustee of the Massachusetts Institute of Technology.

LYNN R. WILLIAMS until recently served as International President of the United Steelworkers of America, a position he held since 1983. He was also Vice President and Executive Council Member both of the AFL-CIO and of its Industrial Union Department. Mr. Williams is a member of numerous organizations including the Collective Bargaining Forum, the National Committee for Full Employment, the Committee for National Health Insurance, the National Planning Association, the National Institute for Dispute Resolution and the Economic Policy Institute.

The Competitiveness Policy Council's Mandate

The Competitiveness Policy Council was created by the Omnibus Trade and Competitiveness Act of 1988. It is charged with making recommendations to the President and Congress on how to improve the nation's competitiveness. The Council's objectives, as stated in Public Law 100-418 (Section 5204), are to:

(1) develop recommendations for national strategies and on specific policies intended to enhance the productivity and international competitiveness of United States industries;

(2) provide comments, when appropriate, and through any existing comment procedure, on—

(A) private sector requests for governmental assistance or relief, specifically as to whether the applicant is likely, by receiving the assistance or relief, to become internationally competitive; and

(B) what actions should be taken by the applicant as a condition of such assistance or relief to ensure that the applicant is likely to become internationally competitive;

(3) analyze information concerning current and future United States economic competitiveness useful to decision making in government and industry;

(4) create a forum where national leaders with experience and background in business, labor, academia, public interest activities, and government shall identify and develop recommendations to address problems affecting the economic competitiveness of the United States;

(5) evaluate Federal policies, regulations, and unclassified international agreements on trade, science, and technology to which the United States is a party with respect to the impact on United States competitiveness;

(6) provide policy recommendations to the Congress, the President, and the Federal departments and agencies regarding specific issues concerning competitiveness strategies;

(7) monitor the changing nature of research, science, and technology in the United States and the changing nature of the Untied States economy and its capacity—

(A) to provide marketable, high quality goods and services in domestic and international markets; and

(B) to respond to international competition;

(8) identify—

(A) Federal and private sector resources devoted to increased competitiveness; and

(B) State and local government programs devised to enhance competitiveness, including joint ventures between universities and corporations;

(9) establish, when appropriate, subcouncils of public and private leaders to develop recommendations on long-term strategies for sectors of the economy and for specific competitiveness issues;

(10) review policy recommendations developed by the subcouncils and transmit such recommendations to the Federal agencies responsible for the implementation of such recommendations;

(11) prepare, publish, and distribute reports containing the recommendations of the Council; and

(12) publish their analysis and recommendations in the form of an annual report to the President and the Congress which also comments on the overall competitiveness of the American economy.

Council Reports and Commissioned Studies

Building a Competitive America, First Annual Report to the President and Congress, March 1, 1992

A Competitiveness Strategy for America, Second Report to the President and Congress, March 1993

Enhancing American Competitiveness: A Progress Report to the President and Congress, October 1993

Reports of the Subcouncils, March 1993

A Trade Policy for a More Competitive America, Report of the Trade Policy Subcouncil to the Competitiveness Policy Council, March 1993

Building High-Performance Workplaces, Report of the Training Subcouncil to the Competitiveness Policy Council, March 1993

Building a Standards-Based School System, Report of the Education Subcouncil to the Competitiveness Policy Council, March 1993

Forging the Future: Policy for American Manufacturing, Report of the Manufacturing Subcouncil to the Competitiveness Policy Council, March 1993

Investing in our Future, Report of the Public Infrastructure Subcouncil to the Competitiveness Policy Council, March 1993

Technology Policy for a Competitive America, Report of the Critical Technologies Subcouncil to the Competitiveness Policy Council, March 1993

Health Care Reform and US Competitiveness, Working Papers Commissioned by the Competitiveness Policy Council, May 1994

Implementing a New Technology Policy, Report of the Critical Technologies Subcouncil to the Competitiveness Policy Council, May 1994

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Acknowledgments

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